TITLE XI
INHERITANCE, ESTATE, GENERATION SKIPPING, AND FIDUCIARY INCOME TAX

CHAPTER 86
INHERITANCE TAX
[Prior to 12/17/86, Revenue Department[730]]

701—86.1(450) Administration.

86.1(1) *Definitions.* The following definitions cover Chapter 86.

a. *"Department"* means the department of revenue and finance.

b. *"Director"* means the director of revenue and finance.

c. *"Administrator"* means the administrator of the audit and compliance division of the department of revenue and finance.

d. *"Audit and compliance division"* is the administrative unit of the department created by the director to administer the inheritance, estate, generation skipping transfer and fiduciary income tax laws of the state.

e. *"Taxpayer"* means a person liable for the payment of the inheritance tax under Iowa Code section 450.5 and includes the executor or administrator of an estate, the trustee or other fiduciary of property subject to inheritance tax and also each heir, beneficiary, surviving joint tenant, transferee or other person becoming beneficially entitled to any property or interest therein by any method of transfer specified in Iowa Code section 450.3, as subject to inheritance tax with respect to any inheritance tax due on their share of the property.

f. *"Tax"* means the inheritance tax imposed by Iowa Code chapter 450.

g. *"Gross estate"* as used for inheritance tax purposes includes all those items, or interests in property, passing by any method of transfer specified in Iowa Code section 450.3 without reduction for liabilities specified in Iowa Code section 450.12. The gross estate for tax purposes may not be the same as the estate for probate purposes. For example, jointly owned property, property transferred with a retained life use, gifts in contemplation of death, transfers to take effect in possession or enjoyment at death, annuities and certain retirement plans, are not part of the decedent's probate estate, but are includable in the decedent's gross estate for inheritance tax purposes. *In re Louden's Estate,* 249 Iowa 1393, 92 N.W.2d 409 (1958); *In re Sayres' Estate,* 245 Iowa 132, 60 N.W.2d 120 (1953); *In re Toy's Estate,* 220 Iowa 825, 263 N.W. 501 (1935); *In re Mann's Estate,* 219 Iowa 597, 258 N.W. 904 (1935); *Matter of Bliven's Estate,* 236 N.W.2d 366 (Iowa 1975); *In re English's Estate,* 206 N.W.2d 305 (Iowa 1973).

h. *"Net estate"* means the gross estate less those items specified in Iowa Code section 450.12 as deductions in determining the net shares of property of each heir, beneficiary, surviving joint tenant or transferee. *In re Estate of Waddington,* 201 N.W.2d 77 (Iowa 1972). Attorney fees and expenses incurred in marshaling assets can be deductible even though not specified in Iowa Code section 450.12. See *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977).

i. *"Gross share"* means the total amount of property of an heir, beneficiary, surviving joint tenant or transferee, without reduction of those items properly deductible in computing the net shares. The total of all gross shares is equal to the gross estate.

j. "*Net share*" means the gross share less the liabilities, if any, which are properly deductible from the gross share of an heir, beneficiary, surviving joint tenant or transferee. The law of abatement of shares is applicable for purposes of determining the net share subject to tax. *In re Estate of Noe,* 195 N.W.2d 361 (Iowa 1972); *Colthurst v. Colthurst,* 265 N.W.2d 590 (Iowa 1978) and *In re Estate of Duhme,* 267 N.W.2d 688 (Iowa 1978). However, see Iowa Code section 633.278 for property subject to a mortgage.

k. "*Personal representative*" shall have the same meaning as the term is defined in Iowa Code subsection 633.3(29).

l. "*Internal Revenue Code*" means the Internal Revenue as defined in Iowa Code section 422.3.

86.1(2) *Delegation of authority.* The director delegates to the administrator of the audit and compliance division, subject always to the supervision and review by the director, the authority to administer the Iowa inheritance tax. This delegated authority specifically includes, but is not limited to, the determination of the correct inheritance tax liability; making assessments against the taxpayer for additional inheritance tax due; authorizing refunds of excessive inheritance tax paid; issuing receipts for inheritance tax paid; executing releases of the inheritance tax lien; granting extension of time to file the inheritance tax return and pay the tax due; granting deferments to pay the inheritance tax on a property interest to take effect in possession or enjoyment at a future date; requesting or waiving the appraisal of property subject to the inheritance tax and the imposition of penalties for failure to timely file or pay the inheritance tax. The administrator of the audit and compliance division may delegate the examination and audit of inheritance tax returns to the supervisors, examiners, agents and clerks of the division.

86.1(3) *Information deemed confidential.* Federal tax returns, federal return information, inheritance tax returns, and the books, records, documents and accounts of any person, firm or corporation, including stock transfer books, requested to be submitted to the department for the enforcement of the inheritance tax law, shall be deemed and held confidential by the department, subject to public disclosure only as provided by law. See 26 U.S.C. Section 6103 pertaining to confidentiality and disclosure of federal tax returns and federal return information.

86.1(4) *Information not confidential.* Copies of wills, probate inventories, trust instruments, deeds and other documents which are filed for public record are not deemed confidential by the department.

86.1(5) *Forms*. The final inheritance tax return, inheritance tax receipts, and forms for the audit, assessment and refund of the inheritance tax shall be in such form as may be prescribed by the director.

This rule is intended to implement Iowa Code chapters 22 and 450 and Iowa Code sections 421.2, 450.67, 450.68, 450.94 and 450B.7.

701—86.2(450) Inheritance tax returns and payment of tax.

86.2(1) *Liability for the tax*. The personal representative of an estate is personally liable for the total tax due from any person receiving property subject to the tax, to the extent of the person's share of the property subject to the jurisdiction of the probate court and the personal representative. The trustee of trust property subject to tax is personally liable for the total tax due from a beneficiary, to the extent of the person's share of the trust property. Each heir, beneficiary, transferee, joint tenant and any other person being beneficially entitled to any property subject to tax, is personally liable for the tax due on all property received subject to the tax. The person is not liable for the tax due on another person's share of property subject to tax, unless the person is also a personal representative, trustee or other fiduciary liable for the tax by reason of having jurisdiction over the property, the succession to which is taxable. *Eddy v. Short,* 190 Iowa 1376, 179 N.W. 818 (1920); *Waterman v. Burbank,* 196 Iowa 793, 195 N.W. 191 (1923).

86.2(2) *Form and content—inheritance tax return.*

a. Estates of decedents dying prior to July 1, 1983. Rescinded IAB 10/13/93, effective 11/17/93.

b. Estates of decedents dying on or after July 1, 1983. For estates of decedents dying on or after July 1, 1983, the preliminary inheritance tax return is abolished and a single inheritance tax return is substituted in lieu thereof. The return shall provide for schedules listing the assets includable in the gross estate, a listing of the liabilities deductible in computing the net estate and a computation of the tax due, if any, on each share of the net estate. The return shall conform as nearly as possible to the federal estate tax return, Form 706. If the estate has filed a federal estate tax return a copy must be submitted with the Iowa return. If the federal estate return includes the schedules of assets and liabilities, the taxpayer may omit the Iowa schedules of assets and liabilities from the return. When Iowa schedules are filed with the return, only those schedules which apply to the particular assets and liabilities of the estate are required. A return merely listing the assets and their values when the gross estate is in excess of $10,000 is not sufficient in nontaxable estates. In this case the return must be amended to list the schedule of liabilities and the computation of the shares of the net estate before an inheritance tax clearance will be issued.

c. Special rule when the surviving spouse succeeds to property in the estate. Effective for estates of decedents dying on or after January 1, 1988, the following rules apply when the surviving spouse succeeds to property in the estate:

(1) If all of the property includable in the gross estate for inheritance tax purposes is held in joint tenancy with right of survivorship by husband and wife alone, an inheritance tax return is not required to be filed and a certificate from the department stating no inheritance tax is due is not required to release the inheritance tax lien under Iowa Code section 450.7(2).

(2) If any of the property includable in the gross estate passes to the surviving spouse by means other than by joint tenancy with right of survivorship or if any property passes by joint tenancy with right of survivorship when the surviving spouse is not the only surviving joint tenant, an inheritance tax return is required to be filed when real estate is part of the gross estate, even though no tax is due, and a certificate from the department is required stating either no tax is due or all tax has been paid in order to satisfy the lien requirement of Iowa Code section 450.7(2).

d. Estates of decedents dying on or after July 1, 1997. In addition to what is set forth in paragraph *"c,"* effective for estates of decedents dying on or after July 1, 1997, Iowa inheritance tax is not imposed when a parent, grandparent, great-grandparent, or any other lineal ascendant, child (including any legally adopted child and biological child entitled to inherit under the laws of this state), stepchild, grandchild, great-grandchild, or any other lineal descendant succeeds to property in the estate. However, an Iowa inheritance tax return is required to be filed with the department of revenue and finance. Despite the fact that Iowa inheritance tax may not be due, a qualifying estate may have an Iowa estate tax obligation.

86.2(3) *Amendments—preliminary return and probate inventory.* Rescinded IAB 10/13/93, effective 11/17/93.

86.2(4) *Who must file—preliminary return and probate inventory.* Rescinded IAB 10/13/93, effective 11/17/93.

86.2(5) *Time for filing—preliminary return and probate inventory.* Rescinded IAB 10/13/93, effective 11/17/93.

86.2(6) *Mandatory filing—inheritance tax return.* The inheritance tax return provided for in subrule 86.2(2) must be filed if the gross share of any heir, beneficiary, transferee or surviving joint tenant exceeds the exemptions allowable in Iowa Code sections 450.4 and 450.9. In addition, if Iowa real estate is includable in the gross estate, the return must be filed, even if no tax is due, prior to the issuance of a no tax due certificate.

86.2(7) *Who must file—inheritance tax return.* If the decedent's estate is probated, the personal representative of the estate shall have the duty of filing the return with the department. If the personal representative of the estate fails to file the return or if the estate is not probated, it shall be the duty of those heirs, beneficiaries, transferees, surviving joint tenants and trustees who receive shares in excess of the allowable exemptions or which are taxable in whole or in part, without the deduction of liabilities, either jointly or severally to file the return with the department.

86.2(8) *Supplemental return—deferred interest.* When the tax has been deferred on a property interest to take effect in possession or enjoyment after the termination of a prior property interest, it shall be the duty of the owner of the future interest to file a supplemental inheritance tax return with the department, reporting the future interest for taxation.

86.2(9) *Amended return.* If additional assets or liabilities deductible are discovered or incurred, as the case may be, after the filing of the inheritance tax return increasing the amount of tax due, an amended inheritance tax return must be filed with the department, reporting the additional assets or liabilities. If additional assets or liabilities are discovered or incurred after the filing of the inheritance tax return, which results in an overpayment of tax, an amended inheritance tax return may be filed, in lieu of a claim for refund.

86.2(10) *Due date for filing—return on present property interests*. Unless an extension of time has been granted, the final inheritance tax return, or the inheritance tax return in case of decedents dying on or after July 1, 1983, must be filed and any tax due paid, for all property in present possession or enjoyment:

a. On or before the last day of the ninth month after death for estates of decedents dying on or after July 1, 1984. The following table for return due dates illustrates this subrule:

Deaths Occurring During:	Return Due Date:
July 1984	April 30, 1985
August 1984	May 31, 1985
September 1984	July 1, 1985 (June 30 is a Sunday)
October 1984	July 31, 1985
November 1984	September 3, 1985 (August 31 is a Saturday and Monday, September 2 is Labor Day)
December 1984	September 30, 1985
January 1985	October 31, 1985
February 1985	December 2, 1985 (November 30 is a Saturday)
March 1985	December 31, 1985
April 1985	January 31, 1986
May 1985	February 28, 1986
June 1985	March 31, 1986

b. Within nine months after death for estates of decedents dying during the period beginning July 1, 1981 and ending June 30, 1984.

86.2(11) *Election to file—before termination of prior estate.* The tax due on a future property interest may be paid, at the taxpayer's election, on the present value of the future interest as follows:

a. On or before the last day of the ninth month after the decedent's death, or within one year after the death of the decedent, for estates of decedents dying prior to July 1, 1984. Compute the tax by applying the life estate, annuity or present value tables to the value of the property at the date of the decedent's death. If age or time is a determining factor in computing the present value of the future interest, it is the age or time at the date of the decedent's death that must be used.

b. After the last day of the ninth month following the decedent's death (one year after death for estates of decedents dying prior to July 1, 1984) but prior to the termination of the prior estate. Compute the tax by applying the life estate, annuity or present value tables to the value of the property at the date the tax is paid. If age or time is a determining factor in computing the present value of the future interest, it is the age or time at the date the tax is paid that must be used. *In re Estate of Wickham,* 241 Iowa 198, 40 N.W.2d 469 (1950); *In re Estate of Millard,* 251 Iowa 1282, 105 N.W.2d 95 (1960). *In re Estate of Dwight E. Clapp,* Clay County District Court, Probate No. 7251 (1980).

86.2(12) *Mandatory due date—return on a future property interest.*

a. For estates of decedents dying prior to July 1, 1984. Rescinded IAB 10/13/93, effective 11/17/93.

b. Mandatory due date—return on a future property interest for estates of decedents dying on or after July 1, 1984. Unless the tax due on a future property interest has been paid under the provisions of subrule 86.2(11), paragraphs *"a"* and *"b,"* the tax due must be paid on or before the last day of the ninth month following the termination of the prior estate. The statute does not provide for an extension of the mandatory due date for payment of the tax.

86.2(13) *Extension of time—return and payment.*

a. For estates of decedents dying prior to July 1, 1984. For good cause, the department may grant an extension of time to file the inheritance tax return and pay the tax due on a property interest in present possession or enjoyment for a period not to exceed ten years after the decedent's death. The nine months (one year for future property interests created prior to July 1, 1981) period to file a supplemental inheritance tax return and pay the deferred tax due on a future estate cannot be extended if the prior estate terminates after the expiration of a previously granted extension of time. Application for an extension of time must be on forms prescribed by the director and must be made prior to the time the tax is due.

b. Extension of time—return and payment—for estates of decedents dying on or after July 1, 1984. The provisions of this subrule also apply to estates of decedents dying on or after July 1, 1984, with the exception that an extension of time to file and pay cannot be extended for a period of time longer than ten years after the last day of the month in which the death of the decedent occurs.

86.2(14) Renumbered as 701—10.85(422), IAB 1/23/91.

86.2(15) Renumbered as 701—subrule 10.85(1), IAB 1/23/91.

86.2(16) Renumbered as 701—subrule 10.85(2), IAB 1/23/91.

86.2(17) Renumbered as 701—subrule 10.85(3), IAB 1/23/91.

86.2(18) Renumbered as 701—subrule 10.85(4), IAB 1/23/91.

86.2(19) Renumbered as 701—subrule 10.85(5), IAB 1/23/91.

86.2(20) Renumbered as 701—subrule 10.85(6), IAB 1/23/91.

86.2(21) *Discount.* There is no discount allowed for early payment of the tax due.

This rule is intended to implement Iowa Code sections 421.14, 450.5, 450.6, 450.9 as amended by 1997 Iowa Acts, Senate File 35, 450.22, 450.44, 450.46, 450.47, 450.51, 450.52, 450.53, 450.63, and 450.94.

701—86.3(450) Audits, assessments and refunds.

86.3(1) *Audits.* Upon filing of the inheritance tax return, the department shall audit and examine it and determine the correct tax due. A copy of the federal estate tax return shall be filed with the inheritance tax return in those estates where federal law requires the filing of a federal estate tax return. The department may request the submission of wills, trust instruments, contracts of sale, deeds, appraisals and such other information as may reasonably be necessary to establish the correct tax due. *Tiffany v. County Board of Review,* 188 N.W.2d 343, 349 (Iowa 1971). For taxpayers using an electronic data interchange process or technology also see 701—subrule 11.4(4). The person or persons liable for the payment of the tax imposed by Iowa Code chapter 450 shall keep the records relating to the gross and net estate required for federal estate tax purposes under 26 U.S.C. Section 6001 of the Internal Revenue Code and federal regulation Section 20.6001-1.

86.3(2) *Assessments for additional tax*. If the audit and examination of the inheritance tax return or claim being filed, to the taxpayer with interest at 6 percent per annum after 60 days from the date of payment until December 31, 1981. See rule 701—10.2(421) for the assessment for the amount of tax due together with any penalty and interest. The amount of the assessment shall be a sum certain if paid on or before the last day of the month in which the notice of assessment is postmarked, or on or before the last day of the following month if the notice is postmarked after the twentieth day of a month and before the first day of the following month. If the inheritance tax return is not filed within the time prescribed by law, taking into consideration any extensions of time, the department may make an assessment for the tax and any penalty and interest due based on the inventories, wills, trust instruments and other information available.

86.3(3) *Refunds*.

a. If the examination and audit of the inheritance tax return discloses an overpayment of tax the department shall refund the excess, without the necessity of an amended return or claim being filed, to the taxpayer with interest at 6 percent per annum until December 31, 1981. See rule 701—10.2(421) for the statutory interest rate commencing on or after January 1, 1982. Interest on refunds shall only be paid on overpayment of tax made in estates of decedents dying on or after July 1, 1975. No interest shall be allowed on refunds due the estates of decedents dying prior to July 1, 1975. (1976 O.A.G. 871.) For estates of decedents dying prior to January 1, 1988, interest shall be computed for a period beginning 60 days from the date of the payment to be refunded. For estates of decedents dying on or after January 1, 1988, interest shall be computed for a period beginning the first day of the second calendar month following the date of the refunded payment, or the date upon which the return which sets out the refunded payment was filed, or the date that return was due to be filed, whichever date is the latest. For the purposes of computing the period, each fraction of a month counts as an entire month. If the taxpayer, after the tax has been paid, discovers additional liabilities which, when offset by any additional assets results in an overpayment of the tax, the excess payment shall be refunded to the taxpayer upon filing with the department either an amended inheritance tax return or a claim for refund. No refund for excessive tax paid shall be made by the department unless a claim or an amended return is filed with the department within three years (five years for estates of decedents dying prior to July 1, 1984) after the tax payment upon which the claim is made became due, or one year after the tax was paid, whichever time is the later.

b. Special rule for refunds for estates electing special use value and qualified terminable interest property.

(1) If an additional inheritance tax has been paid in an estate of a decedent dying on or after July 1, 1983, by reason of the cessation of the qualified use of special use property due to renting the property by the spouse to a member of the family for cash, and the period for claiming a refund has expired under paragraph *"a"* of this subrule, the estate shall nevertheless have until November 10, 1989, to make a claim for a refund of the additional inheritance tax paid.

(2) An estate of a decedent dying on or after July 1, 1985, shall have until November 10, 1990, to make an election not to treat a joint and survivor annuity as passing to the surviving spouse as qualified terminable interest property. If the election made within the time period specified in this subparagraph results in an overpayment of the tax and the period for claiming a refund has expired under 86.3(3)*"a,"* the estate shall nevertheless have until November 10, 1990, to make a claim for a refund of the excessive inheritance tax paid.

86.3(4) *Supplemental assessments and refund adjustments*. The department may, at any time within the period prescribed for assessment or refund adjustment, make a supplemental assessment or refund adjustment whenever it is ascertained that any assessment or refund adjustment is imperfect or incomplete in any respect.

If an assessment or refund adjustment is appealed (protested under rule 701—7.8(17A) and is resolved whether by informal proceedings or by adjudication, the department and the taxpayer are precluded from making a supplemental assessment or refund adjustment concerning the same issue involved in such appeal for the same tax period unless there is a showing of mathematical or clerical error or a showing of fraud or misrepresentation.

86.3(5) *Assessments—period of limitations.* Effective for estates of decedents dying on or after July 1, 1984, assessments for additional tax due must be made within the following periods of time:

a. Within three years after the return is filed for property reported to the department on the return. The three-year period of limitation does not begin until the return is filed. The time of the decedent's death is not relevant. For purposes of determining the period of limitations, the assessment period shall terminate on the same day of the month three years later which corresponds to the day and month the return was filed. If there is no numerically corresponding day three years after the return is filed, or if the expiration date falls on a Saturday, Sunday or holiday, the assessment period expires the preceding day in case there is no corresponding day, or the next day following which is not a Saturday, Sunday, or holiday, as the case may be.

b. The period of time for making an assessment for additional tax is unlimited if a return is not filed with the department.

c. If a return is filed with the department, but property which is subject to taxation is omitted from the return, the three-year period for making an assessment for additional tax on the omitted property does not begin until the omitted property is reported to the department on an amended return. The omission of property from the return only extends the period of limitations for making an assessment for additional tax against the beneficiary, surviving joint tenant or transferee whose share is increased by the omitted property. Shares of the estate are not affected by the omitted assessment period. The inheritance tax is a separate succession tax on each share of the estate, not on the estate as a whole. *In re Estate of Stone*, 132 Iowa 136, 109 N.W. 455 (1906).

86.3(6) *Period of limitations—federal audits.* Effective for audit periods of limitation (three years for estates of decedents dying on or after July 1, 1984) that expire after July 1, 1985, the department, notwithstanding the normal three-year audit period specified in Iowa Code paragraphs 450.94(5)*"a"* and *"b,"* shall have an additional six-month period for examination of the inheritance tax return to determine the correct tax due and for making an assessment for additional tax that may be due.

The additional six-month period begins on the date the taxpayer performs two affirmative acts: (1) notifies the department, in writing, that all controversies with the Internal Revenue Service concerning the federal estate, gift and generation skipping transfer taxes have been concluded and (2) submits to the department a copy of the federal audit, closing statement, court decision or any other relevant federal document concerning the concluded controversy. The additional six-month examination period does not begin until both of the acts are performed. See Iowa Code sections 622.105 and 622.106 for the mailing date as constituting the filing date and Iowa Code section 4.1(22) and *Emmetsburg Ready Mix Co. v. Norris*, 362 N.W.2d 498 (Iowa 1985) when the due date falls on a holiday.

The additional audit period does not limit or shorten the normal three-year examination period. As a result, a six-month additional examination period has no application if the additional six-month examination period would expire during the normal three-year audit period. If additional tax is found to be due, see paragraph 86.12(5)*"b"* for the inheritance tax lien filing requirements for securing the additional tax after an inheritance tax clearance has been issued. The six-month additional examination period means the department shall have at least six months to examine the return after the notification. The department will have more time if the normal three-year examination period expires after the six-month additional period for examination. After the expiration of the normal three-year examination period, and absent an agreement to the contrary, the six-month extension of the statute of limitations for assessing Iowa inheritance tax based on federal audit adjustments for real property is limited to federal audit adjustments that directly affect Iowa inheritance tax and involve Iowa inheritance tax law that incorporates Internal Revenue Code provisions—see Iowa Code section 450.94(5), 701—86.9(450) and 701—86.12(450), and *Kelly-Springfield Tire Co. v. Iowa Board of Tax Review*, 414 N.W.2d 113 (Iowa 1987).

This rule is intended to implement Iowa Code sections 422.25, 422.30, 450.53, 450.65, 450.71, 450.94, 450A.12 and 451.12.

701—86.4(450) Appeals. A determination made by the department of either the correct amount of the tax due, or the amount of refund for excessive tax paid, shall be final unless the taxpayer, or any other party aggrieved by the determination, appeals to the director for a revision of the department's determination. The appeal must be made to the director within 30 days (90 days for determinations made prior to January 1, 1987) from the postmark date of the determination. For notices of assessment issued on or after January 1, 1995, the department will consider a protest to be timely filed if filed no later than 60 days following the date of assessment notice or, if a taxpayer failed to timely appeal a notice of assessment, the taxpayer may make a payment pursuant to rule 701—7.8(17A) and file a refund claim within the period provided by law for filing such claims. In the event of an appeal, the provisions of 701—Chapter 7 of the department's rules of practice and procedure before the department of revenue and finance and Iowa Code chapter 17A shall apply.

This rule is intended to implement Iowa Code chapter 17A and section 450.94 as amended by 1994 Iowa Acts, chapter 1133.

701—86.5(450) Gross estate.

86.5(1) *Iowa tangible property.* Real estate and tangible personal property within a situs in the state of Iowa and in which the decedent had an interest at the time of his death is includable in the gross estate regardless of whether the decedent was a resident of Iowa. It is immaterial whether the property, or interest, is owned singly, jointly, or in common. Certain other real and tangible personal property with a situs in the state of Iowa in which the decedent did not have an interest at death may also be part of the gross estate for tax purposes. Examples of such property transfers include, but are not limited to, transfers of real estate in which the grantor retained a life estate, interest or the power of revocation and gifts made within three years of death which are in contemplation of death. These constitute transfers of property in which the decedent may not have an interest at death, but are includable in the gross estate for inheritance tax purposes. *In re Dieleman's Estate v. Dept. of Revenue,* 222 N.W.2d 459 (Iowa 1974); *In re English's Estate,* 206 N.W.2d 305 (Iowa 1973); and *Lincoln's Estate v. Briggs,* 199 N.W.2d 337 (Iowa 1972).

86.5(2) *Foreign real estate and tangible personal property.* Real estate and tangible personal property with a situs outside the state of Iowa are not subject to the Iowa inheritance tax and, therefore, are not includable in the decedent's gross estate for tax purposes. *Frick v. Pennsylvania,* 268 U.S. 473, 45 S. Ct. 603, 69 L.Ed. 1058 (1925); *In re Marx Estate,* 226 Iowa 1260, 286 N.W.2d 422 (1939).

86.5(3) *Intangible personal property—decedent domiciled in Iowa.* Intangible personal property, or interest therein, owned by a decedent domiciled in Iowa is includable in the gross estate for inheritance tax purposes regardless of the physical location of the evidence of the property or whether the account or obligation is with a non-Iowa financial institution. *Curry v. McCanless,* 307 U.S. 357, 59 S.Ct. 900, 83 L.Ed 1339 (1939); *Lincoln's Estate v. Briggs,* 199 N.W.2d 337 (Iowa 1972).

86.5(4) *Intangible personal property—decedent domiciled outside Iowa.* Intangible personal property may have more than one inheritance tax situs and be subject to multiple state inheritance taxation. Thus, it has been held that the situs of intangible personal property is the place where the owner is domiciled and also where the intangible has acquired a business situs or is located for state inheritance tax purposes. More than one state can subject the succession to such intangible property to tax. *State Tax Commission of Utah v. Aldrich,* 316 U.S. 174, 62 S. Ct. 1008, 86 L.Ed. 1358 (1942); *Curry v. McCanless,* 307 U.S. 357, 59 S.Ct. 900, 83 L.Ed. 1339 (1939); *Chaffin v. Johnson,* 200 Iowa 89, 204 N.W. 424 (1925). Intangible personal property owned by a decedent domiciled outside Iowa may be subject to the Iowa inheritance tax and, therefore, includable in the gross estate if the physical evidence of the property has an Iowa situs or if the intangible property is an account or obligation of an Iowa financial institution. This intangible personal property is not subject to Iowa inheritance tax if the state of domicile subjects the property to a state death tax and either does not subject intangible personal property owned by a decedent domiciled in Iowa to a state death tax, or grants reciprocity to Iowa-domiciled decedents on like intangible personal property. Intangible personal property owned by a decedent domiciled outside Iowa is subject to the Iowa inheritance tax if the state of domicile does not grant an exemption or reciprocity to like intangible personal property owned by Iowa decedents, or does not impose a death tax on intangible property.

86.5(5) *Classification of property.* The property law of the state of situs determines whether property is classified as real, personal, tangible or intangible and also whether decedent had an interest in the property. *Dieleman's Estate v. Dept. of Revenue,* 222 N.W.2d 459 (Iowa 1974); *Williamson v. Youngs,* 200 Iowa 672, 203 N.W. 28 (1925).

86.5(6) *Insurance—in general.* Whether the proceeds or value of insurance is includable in the gross estate for inheritance tax purposes depends on the particular facts in each situation. Designated beneficiary and type of insurance (life, accident, health, credit life, etc.) are some of the factors that are considered in determining whether the value or proceeds are subject to tax. *In re Estate of Brown,* 205 N.W.2d 925 (Iowa 1973).

a. Insurance proceeds subject to tax. The proceeds of insurance on the decedent's life owned by the decedent and payable to the decedent's estate or personal representative is includable in the gross estate. Insurance owned by the decedent on the life of another is includable in the gross estate to the extent of the cash surrender value of the policy. The proceeds of all insurance to which the decedent had an interest, at or prior to death, but are payable for reasons other than death, are includable in the gross estate. *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977).

b. Insurance proceeds not taxable. Insurance on the decedent's life payable to a named beneficiary, including a testamentary trust, other than the insured, the estate, or the insured's personal representative, is not subject to Iowa inheritance tax. *In re Estate of Brown,* 205 N.W.2d 925 (Iowa 1973).

c. Insurance proceeds includable—depending on circumstances. Credit life insurance and burial insurance are offsets against the obligation. If the obligation is deducted in full or in part in computing the taxable shares of heirs or beneficiaries, the proceeds of the credit life and burial insurance are includable in the gross estate to the extent of the obligation. Insurance on the decedent's life and owned by the decedent, pledged as security for a debt is an offset against the debt if the insurance is the primary source relied upon by the creditor for the repayment of the obligation and is includable in the gross estate on the same conditions as credit life insurance. See *Estate of Carl M. Laartz* Probate No. 9641, District Court of Cass County, March 17, 1973; *Estate of Roy P. Petersen,* Probate No. 14025, District Court of Cerro Gordo County, May 16, 1974.

Insurance on the decedent's life, payable to a corporation or association in which the decedent had an ownership interest, while not subject to tax as insurance, may increase the value of the decedent's interest. *In re Reed's Estate,* 243 N.Y. 199, 153 N.E.47, 47 A.L.R. 522 (1926).

86.5(7) *Gifts in contemplation of death—for estates of decedents dying prior to July 1, 1984 only.* A transfer of property, or interests in property by a decedent, except in the case of a bona fide sale for a fair consideration within three years of the grantor's death, made in contemplation of death, is includable in the decedent's gross estate. Any such transfer made within the three-year period prior to the grantor's death is presumed to be in contemplation of death, unless it is shown to the contrary. Whether a transfer is made in contemplation of death depends on the intention of the grantor in making the transfer and will depend on the facts and circumstances of each individual transfer.

a. Factors to be considered are, but not limited to:

(1) The age and health of the grantor at the time of the transfer,

(2) Whether the grantor was motivated by living or death motives,

(3) Whether or not the gift was a material part of the decedent's property,

(4) Whether the gift was an isolated event or one of a series of gifts during the decedent's lifetime.

b. Factors which tend to establish that the motive for the gift was prompted by the thought of death are, but not limited to:

(1) Made with the purpose of avoiding death taxes,

(2) Made as a substitute for a testamentary disposition of the property,

(3) Of such an amount that the remaining property of the grantor would not normally be sufficient to provide for the remaining years of the grantor and those of the grantor's household,

(4) Made with the knowledge that the grantor is suffering from a serious illness that is normally associated with a shortened life expectancy.

c. Factors which tend to establish that the gift was motivated by living motives are, but not limited to:

(1) Made on an occasion and in an appropriate amount that is usually associated with such gift giving occasions as Christmas, birthdays, marriage or graduation,

(2) Made because of the financial need of the donee and in an amount that is appropriate to the need,

(3) Made as a remembrance or reward for past services or favors in an amount appropriate to the occasion,

(4) Made to be relieved of the burden of management of the property given, retaining sufficient property and income for adequate support and maintenance.

For a gift to be determined to have been made in contemplation of death it is not necessary that the grantor be conscious of imminent or immediate death. However, the term means more than the general expectation of death which all entertain. It is a gift when the grantor is influenced to do so by such expectation of death, arising from bodily or mental condition, as prompts persons to dispose of their property to those whom they deem the proper object of their bounty. It is sufficient if the thought of death is the impelling cause for the gift. *U.S. v. Wells,* 283 U. S. 102, 51 S. Ct. 446, 75 L.Ed. 867 (1931); *In re Mann's Estate,* 219 Iowa 597, 258 N.W. 904 (1935).

d. Gifts made within three years of death—for estates of decedents dying on or after July 1, 1984. All gifts made by the donor within three years of death, which are in excess of the annual calendar year federal gift tax exclusion provided for in 26 U.S.C. Section 2503, subsections b and e, are included in the gross estate for inheritance tax purposes. The motive, intention or state of mind of the donor is not relevant. The fact alone that the transfer is a gift, in whole or in part, and exceeds the annual calendar year exclusion for federal gift tax purposes, is sufficient to subject the excess of the transfer over the exclusion to tax. The exclusion is applied to the total amount of the gifts made to a donee in a calendar year, allocating the exclusion to the gifts in the order made during the calendar year. This rule has important application to the earliest year of the three-year period before death because the three-year period for inheritance tax purpose is measured from the date the decedent-donor died. This will only rarely coincide with a calendar year. As a result none of the gifts made in the earliest calendar year of the three-year period prior to death, regardless of the amount, which are made before the beginning of the three-year period, measured by the decedent's death date, is subject to tax. However, gifts made before the three-year period begins in this earliest year will reduce or may completely absorb the exclusion amount that is available for the remaining part of this first-year period. The significance of the difference between the three-year period prior to death and the calendar year exclusion amount is illustrated by the following:

EXAMPLES:

1. The decedent-donor A died July 1, 1985. The three-year period during which gifts may be subject to inheritance begins July 1, 1982. During the calendar year 1982, the decedent-donor made a cash gift to son B of $11,000 on May 1, 1982, and a second gift to B of $4,000 on August 1, 1982. In this example none of the $11,000 gift made on May 1, 1982, is includable for inheritance tax purposes because it was made before the three-year period began, based on the decedent-donor's date of death. All of the $4,000 gift made on August 1, 1982, is includable for inheritance tax purposes because it is in excess of the calendar year 1982 federal gift tax exclusion of $10,000.

2. The decedent-donor A died July 1, 1985. The three-year gift inclusion period for inheritance tax purposes begins July 1, 1982. During the three-year period, based on the decedent's date of death, A made the following gifts to son B: $10,000 on August 1, 1982, and $10,000 on May 1, 1983. Neither gift is includable for inheritance tax purposes because during calendar year 1982 and 1983 neither gift exceeds the federal annual calendar year exclusion. The gifts to B however, would be $20,000 and $10,000 subject to tax if the federal gift tax exclusion year were measured by the decedent's death date instead of a calendar year.

At the election of the donor's spouse, a gift made by a donor to a person, other than the spouse, shall be considered, for inheritance tax purposes, as made one half by the donor and one half by the donor's spouse. This split gift election for inheritance tax purposes is subject to the same terms and conditions that govern split gifts for federal gift tax purposes under 26 U.S.C. Section 2513.

The consent of the donor's spouse signified under 26 U.S.C. Section 2513(b) shall also be presumed to be consent for Iowa inheritance tax purposes, unless the contrary is shown. If the split gift election is made, the election shall apply to all gifts made during the calendar year. Therefore, if the election is made, each spouse may use the annual exclusion ($10,000 for 1984) which shall be applied to one-half of the total value of all gifts made by both spouses during the calendar year to each donee.

Whether a transfer of property constitutes a gift depends on the facts and circumstances surrounding each individual transfer. Transfers which may result in a gift, in whole or in part, include, but are not limited to: sales of property where the purchase price, or terms of sale, are less than fair market value; a loan of money, interest free, even though the loan is payable on demand; the release of a retained life use of property and the payment of a debt or other obligation of another person.

However, certain transfers which in property law would be considered a present transfer of an interest in property may not be considered gifts within the Iowa three-year rule under Iowa Code subsection 450.3(2). Rather the transfers may be transfers intended to take effect in possession or enjoyment at death. Examples of this kind of transfer would include, but are not limited to, transfers in trust or otherwise, with a retained life use or interest; commercial annuities where payments are made to a beneficiary upon the death of the primary annuitant; irrevocable transfers of real or personal property where the deed or bill of sale is placed in escrow to be delivered only upon the grantor's death. Transfers of this kind are subject to inheritance tax under Iowa Code subsection 450.3(3) as a transfer to take effect in possession or enjoyment at death, even though under property law an interest in the property may have been transferred prior to death. Different kinds of transfers that may constitute a taxable gift, in whole or in part, include but are not limited to the following:

EXAMPLES:

1. Grantor-decedent A on July 1, 1982, transferred to son B, without consideration, a 160-acre Iowa farm, reserving the life use. On the date of transfer the farm had a fair market value of $2,000 per acre, or $320,000. On August 1, 1984, A released the retained life estate without any consideration being given and then died on December 1, 1984. The release on August 1, 1984, constitutes a gift, for inheritance tax purposes, of the value of the entire farm (less the annual gift tax exclusion), within the three-year period prior to death. What is taxable is what would have been taxable had the release not been given. *United States v. Allen*, 293 F.2d 916 (10th Cir. 1961); Rev. Ruling 56-324, 1956 2 C.B. 999. In this example the gift is not to be valued at the time of the release of the life use, but rather at its fair market value at the time of death. See subrule 86.9(1). The real estate cannot be valued at its alternate valuation date because it is not included in the federal gross estate for federal estate tax purposes, but rather it constitutes an adjusted taxable gift not eligible for the alternate valuation date. See rule 86.10(450) and Federal Estate Tax Regulation Section 20.2032-1(a) and (d).

2. A, on August 1, 1982, loaned son B $450,000 which was evidenced by a non-interest-bearing promissory note, payable on demand. A died on October 1, 1984, with no part of the loan having been repaid. The principal amount of the note is includable in A's gross estate. The free use of money is a valuable property right to the debtor. *Dickman v. Commissioner*, 465 U.S. 330 (1984). Thus in effect A has made a gift of the value of the interest to B each year the debt remains unpaid. Assuming for purposes of illustration that the applicable federal short-term rate for the entire year is 9 percent for each year and no other gifts were made to B, A has made a gift to B of $40,500 through August 1983 (one year after the note was executed) and an additional gift of $40,500 through August 1, 1984, and two months' interest of $6,750 from August 1, 1984, to the date of death on October 1, 1984. Therefore, in calendar year 1982 A has made a gift of 5/12 of $40,500, or $16,875. After deducting the annual calendar year exclusion of $10,000, $6,875 is subject to inheritance tax. Since the loan was outstanding for all of calendar year 1983, $40,500, less the $10,000 exclusion, or $30,500, is subject to inheritance tax. For calendar year 1984 the loan was outstanding for nine months. Three-fourths of $40,500, less $10,000, or $20,375, is subject to inheritance tax.

In this example it is not necessary that the loan be made within the three-year period prior to death. It is the free use of the loan during the three-year period prior to death that constitutes the gift.

3. On March 1, 1982, A sold a 160-acre Iowa farm to son B for $1,500 per acre, or $240,000. On the date of sale, the fair market value of the farm was $2,500 per acre, or $400,000. A dies on August 1, 1984. This sale is, in part, a gift. It is not a bona fide sale for an adequate and full consideration in money or money's worth and as a result, the difference between the sale price and the fair market value of the farm on the date of sale constitutes a gift. The sale price in this example represents only 60 percent of the farm's fair market value, therefore 40 percent of the farm is a gift. However, the gift percentage to apply to the farm's value at death is 38 percent, not 40 percent, because the $10,000 annual gift tax exclusion must be deducted from the value of the gift. See the computation of this percentage in Example 4 immediately following.

4. On March 1, 1982, A sold a 160-acre Iowa farm to son B for $2,500 per acre, or $400,000, which was also the fair market value of the farm on the date of sale. The sale was an installment sale contract, payable in 20 equal annual installments of principal and interest. The unpaid principal balance is to draw interest at one-half of the prevailing Federal Land Bank loan rate of 12 percent, or 6 percent per year. The annual payments of principal and interest are $34,873.82 per year. A dies on August 1, 1984. In this example the sale price in and of itself does not constitute a gift because the sale price was also the fair market value of the farm. However, the difference between the prevailing Federal Land Bank loan rate of 12 percent and the contract rate of 6 percent constitutes a gift from A to B.

The amount of the gift that is includable in the gross estate is computed by determining the present value of the future annual payments of $34,873.82 discounted to reflect a 12 percent return on the investment. The discounted value is then divided by the fair market value of the farm on the date of the sale to determine the percentage of the sale price that is a bona fide sale for full consideration and the percentage of the sale price that represents a gift before the annual exclusion. The gift percentage is then applied to the fair market value of the farm (or special use value, if applicable) at death, to determine the amount that is includable in the gross estate.

The computation in this example is as follows:

The present value of the future annual payments of $34,873.82 for 20 years to reflect a 12 percent return on an investment is $260,488.05. That is, an investor who desires to earn the market rate of return of 12 percent on an investment would only pay $260,488.05 for this 6 percent $400,000 contract of sale.

Bona Fide Sale Percentage

Present value: 260,488.05 = 65%
Sale price: 400,000.00

This is the percentage of the sale price of $400,000 that represents a bona fide sale for full consideration.

Gift Percentage

The sale price of $400,000 - $260,488.05 or $139,511.95 is the gift portion of the sale price due to the 6 percent interest rate on the contract, before the $10,000 annual exclusion is deducted.

The gift percentage is computed as follows:

$$\$139{,}511.95 - \$10{,}000 = \frac{129{,}511.95}{400{,}000.00} = 32\%$$

In this example the gift percentage used to determine the amount of the farm value at death that is taxable is only 32 percent of the value because deducting the $10,000 exclusion reduced the gift percentage from 35 percent to 32 percent. The gift took place in the year of sale not in the year of death. As a result, 32 percent of fair market value (or special use value, if applicable) of the farm at the time of the donor's death is includable in the gross estate for inheritance tax purposes.

86.5(8) *Joint tenancy property—in general.* Whether the form of ownership of property is considered to be joint tenancy is determined by the property law of the state of the situs of the property. The words and phrases "to A and B as joint tenants with full rights of survivorship and not as tenants in common" create a joint tenancy form of ownership unless a contrary interest can be shown by material evidence. "To A or B, payable to the order of self" creates an alternative right of ownership and for tax purposes is treated as joint tenancy property. *In re Estate of Martin,* 261 Iowa 630, 155 N.W.2d 401 (1968); *Petersen v. Carstensen,* 249 N.W.2d 622 (Iowa 1977); *In re Estate of Louden,* 249 Iowa 1393, 92 N.W.2d 409 (1958). Joint tenancy property may be held by more than two persons. *In re Estate of Horner,* 234 Iowa 624, 12 N.W.2d 166 (1944). However, the use of the words "as joint tenants" alone without the use of the phrase "with right of survivorship" may only create a tenancy in common. *Albright v. Winey,* 226 Iowa 222, 284 N.W. 86 (1939).

a. Joint tenancy property—husband and wife alone. Since there are no shares in joint tenancy property because each joint tenant owns the whole property it is not taxed like tenancy in common property where each owner has a specific share. If the joint tenancy property is held by husband and wife alone, only one half of the property is includable in the gross estate for inheritance tax purposes in the estate of the first joint tenant to die. However, if the survivor can establish by competent evidence that the separate money or property contributed a larger percentage than one-half to the acquisition of a specific item or items of jointly held property, then the larger percentage of such item or items shall be excluded from taxation. *Ida M. Jepsen v. Bair,* No. 85, State Board of Tax Review, June 18, 1975. The one-half exclusion is not automatically available without proof of contribution if any of the surviving joint tenants is not the spouse of the decedent.

b. Joint tenancy property—not held by husband and wife alone. Property held in this form of joint tenancy is includable in the gross estate of the deceased joint tenant, except to the extent the surviving joint tenant or tenants can establish contribution to the acquisition of the joint property, in which case the proportion attributed to the contribution is excluded from the gross estate. In the case of multiple joint tenancy property, excess contribution established by one surviving joint tenant cannot be attributed to another surviving joint tenant. For tax purposes, the requirement of contribution in effect establishes percentage ownership—or shares—in jointly held property that does not exist in property law. Contribution to the acquisition of jointly held property can be established by the survivor by proof, which includes, but is not limited to, evidence that the property was acquired by gift, inheritance or purchase from the survivor's separate funds or property.

c. Joint tenancy—convenience or constructive trust. If the record ownership of bank accounts, certificates of deposit and other kinds of property are held in the form of joint tenancy but in fact are held by the decedent and another person, or persons who have a confidential or fiduciary relationship with the decedent, the property is not held in joint tenancy but is held in constructive or resulting trust by the survivor for the decedent. A confidential or fiduciary relationship is any relationship existing between the parties to a transaction wherein one of the parties is duty bound to act with the utmost good faith for the benefit of the other party. In its broadest connotation, the phrase embraces those multiform positions in life wherein one comes to rely on and trust another in one's important affairs. *First National Bank v. Curran,* 206 N.W.2d 317 (Iowa 1973). The fact that the decedent furnished the funds to acquire the property or demonstrated a kind, considerate and affectionate regard for the survivor does not in itself establish a confidential relationship between the decedent and the survivor. If the evidence to establish a contrary relationship with respect to property in the form of joint tenancy is not substantial, a joint tenancy exists as a matter of law. *Petersen v. Carstensen,* 249 N.W.2d 622 (Iowa 1977).

If a confidential relationship constituting a constructive or resulting trust is established on behalf of the decedent, the property or property interest that is the subject of the trust is part of the decedent's gross estate as singly owned property.

86.5(9) *Transfers reserving a life income or interest.* If the grantor transfers property, except in the case of a bona fide sale for a fair consideration, reserving the income, use, possession, or a portion thereof for life, the property is includable in the gross estate for inheritance tax purposes. *In re Sayres' Estate,* 245 Iowa 132, 60 N.W.2d 120 (1953); *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973). If there is a full reservation of income the entire value of the property in which the reservation exists is includable for tax purposes. If only a portion of the income is reserved the amount subject to tax is the full value of the property at death multiplied by a fraction of which the total income reserved is the numerator and the total average earning capacity of like property is the denominator. See the case of *In re Estate of English,* 206 N.W.2d at 310, for the formula to be used.

The reservation of the life income, or portion thereof, need not necessarily be stated or contained in the instrument of transfer to be includable for taxation. The transfer of property may contain no reservation or other incidents of ownership in the grantor, but if there is a contemporaneous agreement between the grantor and grantee to pay the income, or portion thereof, to the grantor for life, the two instruments or agreements when considered together may be construed to be reservation of the income from the transferred property. See *In re Sayres' Estate,* 245 Iowa 132 at 141, 142, 60 N.W.2d 120 (1953) for a full discussion of the subject.

The instrument need not be in any special form. For example, it may take the form of a contract of sale to terminate at death where the payments consist of the income from the property only. In addition, the transfer to be includable for taxation is not limited to income-producing property. For example, the transfer of the grantor's dwelling, reserving the life occupancy, falls within the meaning of a reserved life income or interest.

86.5(10) *Powers of appointment—in general.* Iowa Code subsection 450.3(4) is concerned with two aspects of powers of appointment that are subject to inheritance tax. First, the taxation of the decedent's property subject to the power of appointment in the estate of the donor (decedent), and second, the exercise, or nonexercise, of the power of appointment over the property in the estate of the donee (the decedent possessing the power).

Transfers by power of appointment were not specifically made subject to inheritance tax until 1921. See section 2(c), chapter 38, Acts of the Thirty-ninth General Assembly; *In re Estate of Higgins,* 194 Iowa 369 at 374, 189 N.W. 752 (1922). From 1921 until July 4, 1965, present Iowa Code subsection 450.3(4) contained only the first sentence of the section. Transfers by exercise of the power of appointment do not concern the creation of the power in the donor's estate. Until a change in the law in 1965, powers of appointment were disregarded in the donor's estate and the donee of the power was taxed as receiving a life estate or term, as the case may be, and those who would take in the event of the nonexercise of the power were taxed as receiving the remainder of the property subject to the power. Prior to 1965 no distinction was made in the donor's estate between a general or special power of appointment.

The second and third sentences of subsection 450.3(4) were added by chapter 366, Acts of the Sixty-first General Assembly (1965). The 1965 amendment addressed itself to the taxation of the transfer which created the power in the donor's estate and a distinction was made for the first time between a general and special power of appointment.

a. General power of appointment. Whether the instrument of transfer utilized by the donor creates a general or special power of appointment is a matter of property law. A devise to A for life with "power to dispose of and pass clear title ... if A so elects," creates a life estate with a general power of appointment. *In re Estate of Cooksey,* 203 Iowa 754, 208 N.W. 337 (1927). Also to A for life, "Especially giving unto A the right to use and dispose of the same as A may see fit," creates a general power of appointment, *Volz v. Kaemmerle,* 211 Iowa 995, 234 N.W. 805 (1931). However, the power to sell and convert the assets subject to the power does not in itself create a general power of appointment. *In re Estate of Harris,* 237 Iowa 613, 23 N.W.2d 445 (1946). A power is general if being testamentary, it can be exercised wholly in favor of the estate of the donee. *In re Estate of Spencer,* 232 N.W.2d 491 at 495, 496 (Iowa 1975). The definition of a general power of appointment contained in 26 U.S.C. Section 2056(b)(5) of the Internal Revenue Code would meet the test of a general power under Iowa law.

b. Special power of appointment. If there is a limitation on the donee's right to use the corpus only for care, maintenance and support, the power is special, not general. *Brown v. Brown,* 213 Iowa 998, 240 N.W. 910 (1932). Also, to A for life with power to handle the property for A's interest, limits the power of invasion of the principal for care and support only, and is therefore a special, not a general, power of appointment. *Lourien v. Fitzgerald,* 242 Iowa 1258, 49 N.W.2d 845 (1951). Also, to A for life, with unrestricted power of sale with no power over the sale proceeds creates only a special power of appointment in the donee. *McCarthy v. McCarthy,* 178 N.W.2d 308 (Iowa 1970).

If the donee's power to appoint is limited to a class or group of persons a special, not a general, power is created. *In re Estate of Spencer,* 232 N.W.2d 491, at 496 (Iowa 1975).

c. Powers of appointment—taxation in donor's estate. If the instrument in the donor's estate creates a general power of appointment, the property subject to the power is taxed as if the property had been transferred to the donee in fee simple. Those who would succeed to the property in the event the power is not exercised, are treated in the donor's estate as if they receive no interest in the property, even though in property law those who succeed to the property either by the exercise, or nonexercise, take from the donor of the power. *In re Estate of Higgins,* 194 Iowa 369 at 373, 189 N.W. 752 (1922); *Bussing v. Hough,* 237 Iowa 194 at 200, 21 N.W.2d 587 (1946).

If the instrument in the donor's estate creates a special power of appointment, the property subject to the power is taxed as if the donee of the power had received a life estate or term for years, as the case may be. Those persons who would take the property in the event the special power is not exercised are taxed in the donor's estate as if they had received the remainder interest in the property subject to the special power, although an election to defer payment of the tax may result in either no tax or a different tax obligation. This could happen, for example, if the special power is the power to invade the corpus for the health, education and maintenance of the donee.

d. Powers of appointment—in the estate of a donee dying prior to January 1, 1988. Iowa Code subsection 450.3(4), prior to the effective date of 1985 Iowa Acts, chapter 148, imposed the tax on property passing under the exercise of a power of appointment. The statute did not draw a distinction between the exercise of a general or special power of appointment. The statute did not impose the tax on property passing by the nonexercise of a power of appointment in the estate of the donee and, therefore, the nonexercise of a power of appointment was not subject to Iowa inheritance tax in the estate of a donee dying prior to January 1, 1988.

It is an underlying assumption that Iowa Code subsection 450.3(4) imposes the inheritance tax on the exercise of the power only if the exercise is to take effect at the death of the donee, or if exercised inter vivos within three years of death (when permitted by the governing instrument) it was exercised in contemplation of death. Any other inter vivos exercise of the power is not within the scope of Iowa Code chapter 450 and, therefore, would not be subject to inheritance tax. What constitutes an exercise of the power of appointment is a matter of property law. When Iowa property is involved, the law of the domicile of the donor and not the law of the domicile of the donee determines whether a power of appointment has been exercised. *Bussing v. Hough*, 237 Iowa 194, 21 N.W.2d 587 (1946). A power of appointment is not exercised by the residuary clause in a will unless an intent to exercise the power appears in addition thereto from the terms of the will. *In re Wills of Proestler*, 232 Iowa 640, 645, 5 N.W.2d 922 (1942); *In re Trust of Stork*, 233 Iowa 413, 420, 9 N.W.2d 273 (1943). The power is exercised, but not limited to, the following three classes of cases: (1) where there has been some reference in the will or other instrument to the power; (2) a reference to the property which is the subject on which the power is to be executed; (3) where the provision in the will or other instrument executed by the donee of the power would otherwise be ineffectual or a mere nullity, in other words, would have no operation except as an execution of the power. *In re Trust of Stork*, 233 Iowa 413, 421, 9 N.W.2d 273 (1943). In the absence of any of these three requirements, it is usually held that the power of appointment does not constitute a part of the estate (of the donee). *In re Wills of Proestler*, 232 Iowa 640, 646, 5 N.W.2d 922 (1942). Even if one of the three criteria has been satisfied the donee must provide for a different disposition of the property subject to the power than was provided for by the donor for there to be a valid exercise of the power. *In re Trust of Stork*, 233 Iowa 413, 424, 9 N.W.2d 273 (1943). If the purported exercise of the power is to the same persons as the takers in default and they take exactly what would have been taken on failure to appoint, the appointment is a nullity and is not subject to tax in the donee's estate. *Cook v. Dove*, 32 Ill.2d 109, 203 N.E.2d 892 (1965).

The test of whether a donee who purports to exercise the power in favor of individuals has in fact exercised the power turns on whether the shares of those who would take in the event of the nonexercise of the power have been altered by the purported exercise. If the share, or shares, have been altered, there has been an exercise of the power, even though only in part, in favor of some person. The rule is this: If the exercise purports to appoint to those individuals who take in default, the same or a smaller share than they would have taken had there been no purported exercise, the power has not been exercised as to those appointees. If the shares of those who would take in default have been altered, the power has been exercised to the extent of the excess over the amount the appointee, or appointees, would have received had the power not been exercised. This rule would apply to an appointment to individuals under both a general and a special power of appointment.

e. Examples—exercise and nonexercise in estate of donee.

(1) Donor A grants to donee B a life estate, with power to appoint the property by will, to C, D and E, and their spouses. In the event of default, the property is devised to C, D and E in equal shares. At the time of B's death, the property subject to the power is valued at $500,000. B by will appoints the entire $500,000 to C and C's spouse in equal shares. The power has been exercised in favor of C's spouse in the amount of $250,000 and to C in the amount of $83,333.33 ($250,000 less $166,666.67) which is one-third of the $500,000 C would have received had the power not been exercised. The power has not been exercised as to D and E because they take less (zero) than they would have taken had the power not been exercised.

(2) Same facts as example (1), only B purports to exercise the power in favor of C, D and E in equal shares. The power has not been exercised because C, D and E receive exactly the same amount of property they would have received had the power not been exercised.

(3) B in examples (1) and (2) makes the same appointment except the appointment is made under a general power of appointment created by A. The result is the same as in examples (1) and (2). The determining questions are not whether the power is a general or special but whether the instrument creating the power authorizes the appointment made and whether the power has been exercised.

f. Powers of appointment in the estate of a donee dying on or after January 1, 1988. Property which is subject to a general power of appointment is includable for inheritance tax purposes in the gross estate of a donee dying on or after January 1, 1988, if the donee has possession of the general power of appointment at the time of the donee's death, or if the donee has released or exercised the general power of appointment within three years of death. Whether or not the donee of a general power exercises the general power at death is not relevant to the includability of the property subject to the general power in the estate of the donee. The mere possession of the power at death is sufficient for the property subject to the power to be included in the estate of the donee for inheritance tax purposes.

Property subject to a special power of appointment is not includable in the gross estate of the donee of the power regardless of whether the donee possesses the special power or exercised the power at death, unless a QTIP election was made under Iowa Code subsection 450.3(7) in which case the rule governing QTIP elections shall control. See paragraphs 86.5(10)*"a"* and *"b"* for the distinction between a general and special power and subrule 86.5(11) for the rule governing QTIP elections.

For inheritance purposes, if there is an exercise or release of the general power within three years of the donee's death, the property subject to the exercise or release is includable in the donee's estate just as if the donee had retained possession of the power at death and is taxable to those to whom the property is appointed in case the power is exercised, or to those who take in default of the exercise in case the power is released.

The general power of appointment is considered to have been exercised for the purposes of this section when the nature of the disposition is such that if it were a transfer or disposition of the donee's property, the transfer would be subject to inheritance tax under Iowa Code section 450.3. For the purposes of subsection 450.3(4), a release of a general power is considered to be a transfer of the property subject to the power to those who would take in default if the power was not exercised.

86.5(11) *Qualified terminable interest property (QTIP).*

a. In general. Effective for estates of decedents dying on or after July 1, 1985, property passing from the decedent grantor-donor, which qualifies as qualified terminable interest property (QTIP) within the meaning of 26 U.S.C. Section 2056(b)(7)(B) is eligible to be treated for Iowa inheritance tax purposes, if an election is made, as passing in fee to the donee-grantee surviving spouse, in the estate of the grantor-donor decedent, subject to the provisions of law and this subrule. If the election is made, the qualified property, unless it is disposed of prior to death, shall be included in the gross estate of the surviving spouse and treated as passing in fee to those succeeding to the remainder interest in the qualified property.

b. Property transfers eligible. Four factors are relevant in determining whether property passing from a decedent grantor-donor is eligible for the Iowa qualified terminable interest election. They are: (1) the death of the decedent-transferor, but not necessarily the transfer, must have occurred on or after July 1, 1985; (2) the property must meet the qualifications required in 26 U.S.C. Section 2056(b)(7)(B), or in the case of a gift within three years of the decedent-transferor's death, the qualifications in 26 U.S.C. Section 2523(f); (3) a federal election must have been made with respect to the qualified property for federal estate tax purposes or, for federal gift tax purposes, if the transfer occurred within three years of the transferor's death, and (4) the property must be included in the decedent-transferor's gross estate for Iowa inheritance tax purposes, either because the transfer occurred at death or within three years of the transferor's death.

If property is not eligible for an Iowa qualified terminable interest election, or if eligible, but an Iowa election is not made, it is not included in the estate of the surviving spouse grantee-donee for inheritance tax purposes by reason of Iowa Code section 450.3. The fact that the qualified property is included in the estate of the surviving spouse for federal estate tax purposes does not necessarily mean the property is automatically included in the surviving spouse's Iowa gross estate.

The treatment of the qualified property in both the grantor-donor's and the surviving spouse's estates for Iowa inheritance tax purposes, is determined by the Iowa election, or lack of an election, being made in the grantor-donor's estate.

This subrule is illustrated by the following examples:

EXAMPLE 1. Decedent A died testate, a resident of Iowa, July 2, 1985, leaving a surviving spouse, B, and two children, C and D. On February 1, 1982, A transferred by deed a 160-acre Iowa farm to spouse B for life, with the remainder at B's death to two children, C and D. An election was made under 26 U.S.C. Section 2523(f) to treat the gift of the 160-acre farm as passing entirely to B in fee.

Upon A's death the 160-acre farm is not part of A's gross estate either for federal estate or for Iowa inheritance tax purposes because the transfer was made more than three years prior to death. However, upon the death of B, the surviving spouse, the 160 acres is included in B's gross estate (unless disposed of prior to death) for federal estate tax purposes, but is not included in B's Iowa gross estate. The transfer by A took place more than three years prior to death, and therefore is not included in A's Iowa estate and is not eligible for an Iowa qualified terminable interest election.

EXAMPLE 2. On October 1, 1982, grantor A executed a revocable inter vivos trust which consisted of cash and a 160-acre Iowa farm. Under the terms of the trust agreement A was to receive the trust income for life and upon A's death the trustee was to pay the trust income to A's spouse B for life, with the power to invade the principal for B's care and support. Upon B's death the trust was to terminate and the balance of the corpus was to be paid to A's children, C and D. A died July 2, 1985, and the personal representative elected to treat the trust assets as passing entirely in fee to the surviving spouse, B, for federal estate tax purposes. An Iowa qualified terminable interest election was not made. In this fact situation the election qualified the trust assets for the marital deduction for federal estate tax purposes. For Iowa inheritance tax purposes, since an Iowa election was not made, the trust assets are taxed on the basis of a life estate passing to B, the surviving spouse, and the remainder passing to the children, C and D. Upon B's death, the trust corpus will be included in B's estate for federal estate tax purposes, but not in B's estate for Iowa inheritance tax purposes, because an Iowa qualified terminable interest election was not made in A's estate.

c. The qualified terminable interest election—in general. The election to treat qualified terminable interest property as passing entirely in fee to the surviving spouse in the estate of the decedent grantor-donor is an affirmative act. In the event an election is not made, the qualified property will be subject to tax on the basis of a life estate passing to the surviving spouse with a remainder over as provided in Iowa Code subsection 450.3(4).

An Iowa election cannot be made unless an election has been made on the same qualified property for federal estate tax purposes, or in case of a gift made within three years of the decedent grantor-donor's death, for federal gift tax purposes. However, even though a federal election has been made, the personal representative of the decedent grantor-donor's estate has the option to either make or not to make the election with respect to the qualified property for Iowa inheritance tax purposes. It is sufficient for Iowa inheritance tax purposes that a valid federal election has been made. What constitutes a valid election for federal estate or gift tax purpose is determined under applicable federal law and practice and not by the department.

However, it is permissible for Iowa inheritance tax purposes to make an election for a smaller but not larger percentage of the qualified property than was made for federal estate or gift tax purposes. These general principles can be illustrated by the following examples:

EXAMPLE 1. Decedent-grantor A created a revocable inter vivos trust on October 15, 1982, which was funded by $200,000 in cash and a 160-acre Iowa farm worth $200,000. The trust provided that the trustee pay the income to A for life and upon A's death, the trustee was to pay the income to A's surviving spouse B for life, with power to invade the principal for B's care and support. Upon B's death the trust was to terminate and the balance of the principal was to be distributed to A's two children, C and D.

A died on July 2, 1985, and the principal of the trust is included in A's gross estate both for federal estate and Iowa inheritance tax purposes because the trust was revocable and A retained the income for life. A's personal representative elected to treat 50 percent of the trust assets as qualified terminable interest property for federal estate tax purposes. A's personal representative elected not to treat the qualified property as passing to B for Iowa inheritance tax purposes. This is permissible because the personal representative has the option to either elect or not to elect to treat 50 percent of the qualified property as passing in fee to the surviving spouse for Iowa inheritance tax purposes.

EXAMPLE 2. Same factual situation as Example 1. A's personal representative elects to treat only 25 percent of the qualified property as passing in fee to the surviving spouse for Iowa inheritance tax purposes. This is permissible because the personal representative is not required to make an election on all of the qualified terminable interest property on which the federal election has been made. It is sufficient that a federal election has been made for at least as large a percentage of the qualified property on which the Iowa election is made. However, an Iowa election cannot be made for a larger percentage of the qualified property than the percentage made on the federal election.

EXAMPLE 3. Same factual situation as Example 1. In this example A's personal representative, for Iowa inheritance tax purposes, purports to elect to treat the $200,000 cash in the trust as passing in fee to the surviving spouse, but not the 160-acre Iowa farm, which is also valued at $200,000. Although the federal estate tax election is for 50 percent of the qualified property, the Iowa election is invalid even though it is made in respect to an asset which is equal in value to 50 percent of the trust principal. If the election is made for less than all of the qualified terminable interest property, the election must be for a fraction of all the qualified property. The personal representative is not permitted to select for the election some qualified assets and reject others. See Federal Estate Tax Regulation 20.2056-1(b).

d. The election—manner and form. The qualified terminable interest election shall be in writing and made by the personal representative of the decedent grantor-donor's estate on the Iowa inheritance tax return. The election once made shall be irrevocable. If the election is not made on the first inheritance tax return, the election may be made on an amended return, provided the amended return is filed on or before the due date of the return (taking into consideration any extensions of time granted to file the return and pay the tax due). The personal representative may make an election on a delinquent return, provided it is the first return filed for the estate. Failure to make the election on the first return filed after the due date has passed precludes making an election on a subsequent return. See 26 U.S.C. Section 2056(b)(7)(B)(V) and Internal Revenue Service Letter Ruling 8418005.

The election consists of two affirmative acts performed by the personal representative on the inheritance tax return: (1) by answering in the affirmative the question—Is the estate making a qualified terminable interest election with respect to the qualified property? and (2) by computing the share of the surviving spouse to include the qualified terminable interest property on which the election was made. In the event of an inconsistency in complying with the two requirements, the treatment given to the share of the surviving spouse shall be controlling.

e. Disposition of qualified property prior to death. A disposition of all or part of the qualified property, which was the subject of the qualified terminable interest election, prior to the death of the surviving spouse, voids the election as to that portion of the property disposed of that is not retained by the surviving spouse. In this event, the portion of the qualified property not retained by the surviving spouse shall be taxed to those succeeding to the remainder interests in the disposed property as if the tax on the remainder interest had been deferred under Iowa Code sections 450.44 to 450.49. Except in the case of special use valuation property, the tax shall be based on the fair market value of the amount of the qualified property not retained by the surviving spouse at the time the property was disposed of. *In re Estate of Wickham,* 241 Iowa 198, 40 N.W.2d 469 (1950), see subrule 86.11(5) for taxation of remainder interests when the tax is deferred. The alternate valuation date cannot be used in computing the tax. See subrule 86.10(2). If QTIP property has been valued at its special use value under Iowa Code chapter 450B, and is disposed of prior to the death of the surviving spouse, the portion of the QTIP property not retained by the surviving spouse shall be valued for taxation as follows:

1. At its special use value at the time of its disposition, if the QTIP property remains in qualified use under 26 U.S.C. Section 2032A.

2. At its fair market value at the time of its disposition, if there is a cessation of the qualified use under 26 U.S.C. Section 2032A. In case there is a cessation of the qualified use, the recapture tax provisions of Iowa Code section 450B.3 shall not apply. The tax on the remainder interest is treated as a payment of tax deferred and subject to the rules on deferred tax and not a recapture, with interest, of the tax originally imposed in the decedent grantor-donor's estate.

f. Inclusion in the estate of the surviving spouse. Upon the death of the surviving spouse the qualified terminable interest property, which was the subject of an election, that was not disposed of prior to death, shall be included in the gross estate of the surviving spouse and be treated as if it passed in fee from the surviving spouse to those succeeding to the remainder interests. The included QTIP property will receive a stepped up basis for gain or loss as property acquired from a decedent. See 26 U.S.C. Section 1014(b)(10). The relationship of the surviving spouse to the owners of the remainder interest shall determine whether the individual exemptions provided for in Iowa Code section 450.9 apply and which tax rate in Iowa Code section 450.10 shall be applicable.

Qualified property included in the estate of the surviving spouse shall be valued as if it passed from the surviving spouse in fee and shall be valued either (1) at the time of the surviving spouse's death under the provisions of Iowa Code section 450.37 and rule 86.9(450), or at its special use value under Iowa Code chapter 450B and rule 86.8(450B), if the real estate is otherwise qualified; or (2) at the alternate valuation date under the provisions of Iowa Code section 450.37(1)(b) and rule 86.10(450), if the property is otherwise eligible.

This subrule can be illustrated by the following examples:

EXAMPLE 1. Decedent A died testate on July 2, 1985, survived by a spouse, B, aged 65, and two stepchildren, C and D. Under A's will all property was left in trust to pay all of the income the trust was to terminate and the principal was to be divided equally between C and D, who are the children of surviving spouse B. The personal representative elected to treat the trust assets as passing entirely in fee to surviving spouse B. The net corpus of the trust consists of a 160-acre farm valued at $200,000 and personal property valued at $200,000.

Tax on the basis of all property passing in fee to B

Share	Tax
$400,000	$13,425.00

EXAMPLE 2. Same facts as Example 1, with the exception the personal representative did not make an Iowa qualified terminable interest election. In this fact situation the trust assets are taxed on the basis of a life estate passing to surviving spouse B with a remainder over to C and D.

Share		Tax
Spouse B: Life estate factor .35817		
$400,000 × .35817 = $143,268		-0-
C's share ½ remainder factor .64183		
$400,000 × .64183 ÷ 2 = $128,366		$ 9,427.94
D's share—same as C's share $128,366		9,427.94
Total	$400,000	$18,855.88

In Example 1, the qualified terminable interest election cost the surviving spouse $13,425.00 in tax, but as shown in Example 2, it would cost the children, C and D, $18,855.88 if the election had not been made. The election resulted in a net saving to the estate of $5,430.88 ($18,855.88 - $13,425.00 = $5,430.88).

EXAMPLE 3. B, the surviving spouse of A in Example 1, died testate, a resident of Iowa, on October 15, 1986. Under the terms of B's will, B's children, C and D, inherit B's entire estate in equal shares. B's net estate consists of $200,000 in personal property and a 160-acre Iowa farm with a value of $200,000 both of which were the subject of a qualified terminable interest election in A's estate and in which C and D own the remainder interest. B paid $13,425 in tax on the $400,000 qualified property in A's estate because of the qualified terminable election. If the election had not been made, the inheritance tax on a life estate in the $400,000 would have been zero, because at age 65 at the time of A's death the exemption of a spouse of $180,000 was more than the $143,268 value of the life estate. B's net estate also consisted of $100,000 in intangible personal property which B owned in fee simple, plus the right to recover the $13,425 additional tax paid on the qualified property in A's estate.

B's net estate for Iowa inheritance tax purposes consists of the following:
$200,000, personal property from A's estate.
$200,000, 160-acre farm from A's estate.
$100,000, owned by B in fee simple.
$ 13,425, additional tax paid in A's estate which is subject to a right of recovery.
$513,425 Total

The shares of C and D and their tax owed in B's estate are computed as follows:

Share		Tax	
Beneficiary C: ½ of the net estate, or	$256,712.50	$12,362.00	
Less: ½ of the credit of $13,425.00 paid by B on the qualified property in A's estate (see credit limit computation below)		$(6,712.50)	$ 5,649.50
Beneficiary D: (same as C)	$256,712.50		$ 5,649.50
Totals	$513,425.00		$11,299.00

Note Credit Limitation in B's Estate

The credit C and D are entitled to in B's estate for the tax B paid on the qualified terminable interest property in A's estate cannot exceed the percentage of the tax generated in B's estate by including the qualified property. The percentage is computed as follows:

$$\frac{\text{Qualified property in B's estate}}{\text{B's total net estate}} = \frac{\$400{,}000}{\$513{,}425} = 77.91\%$$

The credit limit for beneficiary B is:

77.91% × $12,362.00 = $9,331.23. The tax credit therefore is the lesser of $9,331.23 or $6,712.50 (which is C's half of the tax B paid in A's estate in Example 1). The credit limitation therefore does not apply in this example. The statute makes no provision for a refund in the event the credit is greater than the beneficiary's tax liability.

g. The QTIP tax credit and the credit for tax on prior transfers. The credit for the additional tax paid by the surviving spouse in the estate of the decedent grantor-donor on property which was the subject of a qualified terminable interest election, is governed exclusively by the provisions of Iowa Code section 450.3 and these rules. The credit for tax paid on prior transfers allowable under Iowa Code section 450.10, subsection 6, shall not apply. However, property received by the surviving spouse from the estate of the decedent grantor-donor, which was not the subject of a qualified terminable interest election, is eligible for the credit for the tax paid on a prior transfer, if the conditions of Iowa Code chapter 450B are otherwise met.

86.5(12) *Annuities.*

a. General rule. Annuities in general are considered to be taxable under Iowa Code subsection 450.3(3) as a transfer made or intended to take effect in possession or enjoyment after the death of the grantor or donor. *In re Estate of English,* 206 N.W.2d 305 (Iowa 1973); *In re Endemann's Estate,* 307 N.Y. 100, 120 N.E.2d 514 (1954); *Cochrane v. Commission of Corps & Taxation,* 350 Mass. 237, 214 N.E.2d 283 (1966).

b. Exception to the general rule. Iowa Code subsection 450.4(5) provides for an exception to the general rule of taxability of annuities. The exception is limited to the portion of the annuity payment, which wholly or in part, as the case may be, is includable as net income for Iowa income tax purposes under Iowa Code section 422.7. In addition, to come within the exception, the annuity must be derived from an employee's pension or retirement plan. The exclusion makes reference only to installment payments and not to lump-sum distributions to a beneficiary. It is within the exclusion, if the payments, or a portion as the case may be, are subject to Iowa income tax irrespective of the type of income tax treatment given the payments. Whether the payments be includable as ordinary income, receive capital gain treatment, or are eligible for income averaging (for federal income tax purposes) is not material to determining the exclusion.

Prior to 1961 the department subjected to inheritance tax the commuted value of the full amount of each annuity payment regardless of whether the annuity was derived from an employee's pension or retirement plan or not. This resulted in a portion or all of the annuity payments being subject to both inheritance and income taxes in certain circumstances.

In 1961, Iowa Code subsections 450.4(5) and 422.7(4) were enacted by the Fifty-ninth General Assembly. See section 1, chapter 238 and section 1, chapter 227 respectively. It has been said the two exclusion sections are circular and confusing. See *Kurtz and Reimer, Iowa Estates: Taxation and Administration,* section 16.30 (1975). Iowa Code subsection 450.4(5) purports to exclude from inheritance tax what is subject to income tax and Iowa Code subsection 422.7(4) purports to exclude from income tax what was subject to inheritance tax. The apparent ambiguity can be resolved by an analysis of Iowa Code subsection 422.7(4). Subsection 422.7(4) excludes from income tax the commuted value of the installment payments, not just a portion of the payments. "Commuted value" has been defined as the sum necessary to provide future payments as provided for in an annuity policy. In other words, the present value of the full amount of each annuity payment is the commuted value. This can be construed to mean only those estates which had been taxed for inheritance tax purposes on the full amount of each installment payment are entitled to the income tax exclusion.

Therefore, Iowa Code subsection 422.7(4) addresses itself only to those beneficiaries of estates of decedents dying prior to 1961, whose gross share of the estate subject to Iowa inheritance tax included the commuted value of the full amount of each installment payment. As a result, since 1961, the exclusion under Iowa Code subsection 450.4(5) alone and by itself prevents the double taxation of the portion of the installment payments subject to income tax. Thus the circuity problem is avoided by first ascertaining whether the installment payments, or a portion thereof, are subject to Iowa income tax. The rule since 1961 is this: First determine what portion (which may be all or none) of the installment payments will be subject to Iowa income tax; the portion thus determined is exempt from Iowa inheritance tax. The present value of the portion of the installment payments remaining after the portion subject to income tax has been excluded is includable in the gross estate for inheritance tax purposes.

86.5(13) *Distribution of trust property.* Property of a trust can be divided into two or more trusts, or one or more separate trusts can be consolidated with one or more other trusts into a single trust by dividing the property in cash or in kind, including in undivided interests, by pro-rata or non-pro-rata division or in any combination thereof. Division of property between trusts in this manner does not result in a "sale" of the divided property and a corresponding taxable gain.

This rule is intended to implement Iowa Code sections 422.7(4), 450.2, 450.3, 450.4(5), 450.8, 450.12, 450.37, 450.91, 633.699, and 633.703A as amended by 1997 Iowa Acts, House File 266.

701—86.6(450) The net estate.

86.6(1) *Debts*. For estates of decedents dying prior to July 1, 1983. In general, Iowa Code section 450.12 provides for the deduction of "debts" before computing the tax due. The term "debts" used in Iowa Code section 450.12 is broader than debts of the decedent. The term includes, but is limited to, those other items specifically allowed as deductions under this section of the Iowa Code. In order to prevent confusion in the different meanings of the word "debt," the term "liabilities" is used in this rule to include all those items allowed as deductions under Iowa Code section 450.12.

If any doubt or ambiguity exists whether an item is deductible or not, it is to be strictly construed against the taxpayer. Therefore, the burden is on the taxpayer to establish that an item is deductible. *In re estate of Waddington,* 201 N.W.2d 77 (Iowa 1972).

The department may require the taxpayer to furnish reasonable proof to establish the deductible items, such as, but not limited to, canceled checks in payment of an obligation, copies of court orders allowing claims against the estate, attorney and fiduciary fees, allowances for the surviving spouse and copies of notes and mortgages.

Iowa Code section 450.12 draws a distinction between the liabilities that are deductible in the estate of a decedent who was domiciled in Iowa at the time of death and the liabilities that are deductible in estates of decedents domiciled outside of Iowa at death. Iowa Code subsection 450.12(2), which lists the items that are deductible for estates of decedents domiciled outside Iowa, should be construed in conjunction with Iowa Code section 450.89 which also provides for the deduction of debts in foreign estates. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955).

86.6(2) *Liabilities deductible—Iowa residents*. For estates of decedents dying prior to July 1, 1983.

a. Debts owing by decedent. A debt to be allowed as a deduction in determining the net estate under Iowa Code section 450.12 must be the liability of the decedent and also be owing and not discharged at the time of the decedent's death. The amount allowable as a deduction is the principal amount due, plus interest accruing to the day of the decedent's death. If the decedent is not the only person liable for the debt, only a portion of the debt shall be deducted for inheritance tax purposes. The portion deducted is based on the number of solvent obligors. If a joint and several debt has more than one obligor and one obligor pays the remaining balance owed on the debt, the obligor who pays the remaining debt has a right of contribution for payment of the debt against the other solvent obligors. If the decedent is the obligor and the estate pays the remaining balance of the debt, the estate must list the right of contribution as an asset on the Iowa inheritance tax return. *In re Estate of Tollefsrud,* 275 N.W.2d 412 (Iowa 1979); *In re Estate of Thomas,* 454 N.W.2d 66 (Iowa App. 1990); *Estate of Pauline Bladt,* Department of Revenue and Finance, Hearing Office Decision, Docket No. 95-70-1-0174 (December 16, 1996). The term "debt owing by the decedent" is not defined in Iowa Code section 450.12. However, Iowa Code section 633.3(10) (probate code) defines "debts" as including liabilities of the decedent which survive, whether arising in contract, tort or otherwise.

Examples of what the term "debt of the decedent" does not include are but not limited to taxes, which are an impost levied by authority of government upon its citizens or subjects for the support of the state. *Eide v. Hottman,* 257 Iowa 263, 265, 132 N.W.2d 755 (1965). Promissory notes executed by the decedent without consideration are not debts of the decedent and are not allowable as a deduction in determining the net estate subject to tax. *In re McAllister's Estate,* 214 N.W.2d 142 (Iowa 1974). Payments to persons in compromise of their claim to a portion of the estate made by those persons who take from the decedent, are not debts nor treated as expenses of settlement. *In re Estate of Bliven,* 236 N.W.2d 366, 371 (Iowa 1975); *In re Estate of Wells,* 142 Iowa 255, 259, 260, 120 N.W. 713 (1909).

Iowa Code subsection 450.12(1) provides that debts owing by the decedent to be allowable in computing the net estate must be the type of obligation of the decedent for which a claim could be filed and be enforced in the probate proceedings of the estate. *In re Estate of McMahon,* 237 Iowa 236, 21 N.W.2d 581 (1946); *In re Estate of Laartz,* Cass County District Court, Probate No. 9641 (1973); *In re Estate of Tracy,* department of revenue and finance hearing officer decision Docket No. 77-167-3-A (1977). Filing a claim in probate proceedings is not a prerequisite for the allowance of the liability as a deduction in computing the net estate. It is sufficient that the liability is enforceable against the decedent's estate and will be paid. Claims in probate founded on a promise or agreement are deductible only to the extent they were contracted bona fide and for an adequate and full consideration. *In re McAllister's Estate,* 214 N.W.2d 142 (Iowa 1974).

If the debt is not paid at the time the final inheritance tax return is filed (which is frequently the case in installment obligations) the burden is on the taxpayer to establish, if requested by the department, that the debt will be paid at a future date. The validity of a claim in probate based on a liability of the decedent is subject to review by the department. *In re Estate of Stephenson,* 234 Iowa 1315, 1319, 14 N.W.2d 684 (1944).

b. Mortgages—decedent's debt. A mortgage or other encumbrance securing a debt of the decedent on Iowa property in which the decedent had an interest is allowable as a deduction in determining the net estate in the same manner as an unsecured debt of the decedent, even though it may be deducted from different shares of the estate than unsecured debts. (See Iowa Code section 633.278.) However, if the debt of the decedent is secured by property located outside Iowa, which is not subject to Iowa inheritance tax, the debt is allowable as a deduction in determining the net estate, only in the amount the debt exceeds the value of the property securing the debt.

c. Mortgages—not decedent's debt. If the gross estate includes property subject to a mortgage or other encumbrance which secures a debt which is not enforceable against the decedent, the amount of the debt, including interest accrued to the day of death, is deductible, not as a debt of the decedent, but from the fair market value of the encumbered property. The deduction is limited to the amount the decedent would have had to pay to remove the encumbrance less the value, if any, of the decedent's right of recovery against the debtor. See *Home Owners Loan Corp. v. Rupe*, 225 Iowa 1044, 1047, 283 N.W. 108 (1938) for circumstances under which the right of subrogation may exist.

d. Mortgages—nonprobate property. A debt secured by property not subject to the jurisdiction of the probate court, such as, but not limited to, jointly owned property and property transferred within three years of death and in contemplation of death is deducted in the same manner as a debt secured by probate property. The fact the property is includable in the gross estate is the controlling factor in determining the deductibility of the debt (providing the debt is otherwise deductible).

e. Local and state taxes. The taxes deductible are limited to Iowa state and local taxes. *In re Estate of McMahon*, 237 Iowa 236, 21 N.W.2d 581 (1946). The deductible taxes would include taxes on real and personal property, sales and use taxes, income tax and special school district income taxes which are due and unpaid at the time of the decedent's death, including tax on income received during the year of, but prior to, death and miscellaneous Iowa taxes, such as motor vehicle fuel taxes. To be deductible under this category, the obligation must be a tax and not a user charge, such as a sewer fee, which is more properly categorized as a debt. Special assessments on property and penalty and interest accrued to the day of death on taxes owed by the decedent are deductible, not as taxes, but as an offset against the value of the property or as a debt of the decedent as the case may be. However, for administrative convenience, it is permissible to list and deduct such liabilities in the same manner as taxes. Taxes to be deductible must be due and owing at death during the period beginning July 1 and ending June 30 in which the decedent's death occurs.

EXAMPLE 1—On May 15, 1980, the county board of supervisors levied a tax in the sum of $1,500 on decedent's Iowa real estate. Decedent died July 2, 1980. The entire real estate tax is deductible (it is assumed the taxes were unpaid) because the taxes became due and payable July 1, 1980.

EXAMPLE 2—Same facts as in Example 1, only the decedent died December 1, 1980. Assuming only the first half of the real estate taxes had been paid in September 1980, the second half ($750) would be deductible from the decedent's gross estate.

EXAMPLE 3—Same facts as in Example 1, except the decedent died June 15, 1980. No real estate taxes are deductible (it is assumed the decedent had paid the taxes due during the period July 1, 1979 to June 30, 1980) even though the taxes were levied and became a lien May 15, 1980, prior to decedent's death, because they are not due and payable until July 1, 1980. See *In re Estate of Luke*, 184 N.W.2d 42 (Iowa 1971) for determining when real estate taxes become a lien as distinguished from when they are payable.

The inheritance tax imposed in the decedent's estate is not a tax on the decedent's property nor is it a state tax due from the estate. It is a succession tax on a person's right to take from the decedent. The tax is the obligation of the person who succeeds to property included in the gross estate. *Wieting v. Morrow*, 151 Iowa 590, 132 N.W. 193 (1911); *Waterman v. Burbank*, 196 Iowa 793, 195 N.W. 191 (1923). Therefore, inheritance tax is not a deduction in determining the net estate of the decedent in which the tax was imposed. However, if a taxpayer dies owing an inheritance tax imposed in another estate, the tax imposed in the prior estate, together with any penalty and interest owing, if any, is a deduction as a state tax due in the deceased taxpayer's estate.

f. Federal taxes. Deductible under this category are the federal taxes such as federal income and gift taxes owing by the decedent at the time of death, including any penalty and interest accrued to the day of death. Federal income taxes on the decedent's income received during the year of, but prior to death are deductible. Also deductible are the federal taxes paid from the estate on Iowa property. The term "paid from the estate on Iowa property" is a term of limitation and therefore only the portion of the federal estate tax attributable to Iowa property is deductible. The deduction is limited to the net federal tax owing after all allowable credits, such as the federal credit for state death taxes paid, have been subtracted. Any penalty and interest imposed or accruing on federal taxes after the decedent's death is not deductible. The general rule for determining the amount of federal estate tax which is deductible is as follows: Multiply the total net federal estate tax owing by the fraction of which the total Iowa gross estate for federal estate purposes is the numerator and the total gross estate for federal estate tax purposes is the denominator. The general rule is illustrated by the following example:

EXAMPLE: Decedent died July 1, 1980, a resident of the state of Arizona, survived by two children who are the sole beneficiaries under decedent's will. The gross estate for federal estate tax purposes is composed of a 160-acre Iowa farm, valued at $320,000, grain on hand, with a situs in Iowa valued at $20,000, and a dwelling and intangible personal property with a situs in Arizona valued at $150,000. The estate has liabilities of $75,000, which are allowed in computing the federal adjusted gross estate. The federal estate tax paid was $84,400, less $7,280 credit for state death taxes, or $77,120.

The amount of federal estate tax deductible for Iowa inheritance tax purposes is computed as follows:

Federal Gross Estate		Iowa Gross Estate	
Iowa real estate	$320,000	Iowa real estate	$320,000
Iowa grain	20,000	Iowa grain	20,000
Arizona property	150,000		
Total gross estate	$490,000	Total Iowa gross estate	$340,000

Iowa gross estate: $340,000
Total gross estate: $490,000
× $77,120 = $53,511.84

$53,511.84 is the federal estate tax deduction for Iowa inheritance tax purposes.

However, if it is established, either by the department or the taxpayer, that the taxable estate for federal estate tax purposes includes Iowa property in a greater or lesser proportion than would result by applying the ratio computed under the general rule (for example, Iowa property included in the marital share or property devised in part to charity), then such greater or lesser proportion of Iowa property shall govern the ratio used in computing the deduction for federal estate taxes paid. The foregoing special rule is illustrated by the following example:

EXAMPLE: The decedent died July 1, 1980, a resident of the state of Nebraska, survived by a spouse and two children. Under the terms of the decedent's will the spouse was given one half of the adjusted gross estate for federal estate tax purposes (the gross estate less the debts and expenses) which was to include the family dwelling in Nebraska. The will directed the federal estate and inheritance taxes be paid out of the remaining estate which was given to the two children equally.

The adjusted gross estate for federal estate tax purposes consists of the following assets:

Asset	Value
240-acre Iowa farm	$480,000
Nebraska intangible property	80,000
Nebraska residence	75,000
Iowa grain	35,000
Total gross estate	$670,000
Less debts and expenses	70,000
Adjusted gross estate	$600,000

Property subject to Federal Estate Tax	
Iowa farm	$480,000
Iowa grain	35,000
Nebraska intangible property	80,000
Total	$595,000

The spouse's share (one-half of $600,000), which includes the residence, is not subject to federal estate tax. The federal estate tax on the remaining $300,000 is $41,700 ($45,300 less $3,600 credit for state death taxes paid).

The Iowa property ($480,000 + $35,000/$595,000) is 87 percent of the total property subject to federal estate tax. The federal estate tax deduction for Iowa inheritance tax purposes is $41,700 × .87 or $36,279. This is so even though the Iowa property is only 77 percent of the total gross estate because a larger proportion of the Iowa property is subject to federal estate tax.

g. Funeral expenses. The deduction is limited to the expense of the decedent's funeral. If the decedent at the time of death was liable for the funeral expense of another, such expense is categorized as a debt of the decedent and is deductible subject to the same conditions as other debts of the decedent. *In re Estate of Porter,* 212 Iowa 29, 236 N.W. 108 (1931). A devise in the decedent's will, or a direction in a trust instrument, to pay the funeral expense of a beneficiary upon death is an additional inheritance in favor of the beneficiary and not a funeral expense deductible in the estate of the testator or grantor. Funeral expense is the liability of the estate of the person who has died. *In re Estate of Kneebs,* 246 Iowa 1053, 70 N.W.2d 539 (1955).

What constitutes a reasonable expense for the decedent's funeral depends upon the facts and circumstances in each particular estate. Factors to be considered are, but not limited to: the decedent's station in life and the size of the estate, *Foley v. Brocksmit,* 119 Iowa 457, 93 N.W. 344 (1903); the decedent's known wishes (tomb rather than a grave), *Morrow v. Durant,* 140 Iowa 437, 118 N.W. 781 (1908). Funeral expense includes the cost of a tombstone or monument. *In re Estate of Harris,* 237 Iowa 613, 23 N.W.2d 445 (1946). A reasonable fee or honorarium paid to the officiating clergy is a deductible funeral expense. *In re Estate of Kneebs,* 246 Iowa 1053, 1058, 70 N.W.2d 539 (1955). It is not a prerequisite for deductibility that a claim for funeral expenses be filed and allowed in the probate proceedings. It is sufficient that the expense be paid and be in an amount that would be enforceable in the decedent's estate if a claim in probate had been filed. *In re Estate of Ewing,* 234 Iowa 950, 14 N.W.2d 633 (1944). The deduction allowable is limited to the net expense of the decedent's funeral, after deducting any expense prepaid by the decedent, burial insurance or death benefit, such as the death benefit allowed by the veterans administration or the social security administration.

h. Allowance for surviving spouse and dependents. An allowance for the support of the surviving spouse and dependents to be deductible in determining the net estate for taxation must meet two conditions: First it must be allowed and ordered by the court and second it must be paid from the assets of the estate that are subject to the jurisdiction of the probate court. The allowance is not an additional exemption for the spouse or children. It is part of the costs of administration of the decedent's estate. Iowa Code section 633.374. *In re Estate of DeVries,* 203 N.W.2d 308, 311 (Iowa 1972). Upon request of the department, the taxpayer shall submit a copy of the order of court providing for the allowance and copies of canceled checks or other documents establishing payment of the allowance.

For the purpose of determining the shares of heirs or beneficiaries for inheritance tax, the allowance is a charge against the corpus of the shares of the estate even though it is paid from the income of the shares. The allowance is included with the other debts and charges for the purpose of abatement of shares to pay the debts and charges of the estate.

i. Court costs. The deduction under this category is limited to Iowa court costs only. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955). The term "court costs" is not synonymous with "costs of administration" as defined in Iowa Code subsection 633.3(8) or "administration expenses" under Section 2053(a) of the Internal Revenue Code. See federal regulation Section 20.2053-3(d). Court costs is the narrower term. Court costs are part of costs of administration in Iowa and are an expense of administration under the Internal Revenue Code, but not all costs or expenses of administration are court costs. For example, interest payable on an extension of time to pay the federal estate tax is a cost of administration in the estate in which the federal estate tax is imposed, but it is not part of court costs, and therefore not deductible for inheritance tax purposes.

In general, court costs include only those statutory fees and expenses relating directly to the probate proceeding, carried on the clerk's docket, and paid routinely in the process of closing every estate. *In re Estate of Waddington,* 201 N.W.2d 77, 79 (Iowa 1972). The term "court costs" since August 15, 1975, also includes the expenses of selling property. See Iowa Code subsection 633.3(8).

j. Cost of appraisal. The appraisal costs deductible are the fees and mileage for the services of the inheritance tax appraisers appointed by the court under Iowa Code section 450.24. The deduction is limited to the expense of the appraisal authorized by statute. The expense of private appraisers employed by the estate, or a person interested in the estate, is not deductible, even though it may constitute a cost of administration in certain circumstances. The appraisal costs are limited to the costs of appraising property includable in the Iowa estate for inheritance tax purposes.

k. Fee of fiduciary. For the purpose of determining the deduction for fees under Iowa Code section 450.12 the term "fiduciary" includes an executor, administrator, trustee, or other personal representative, both temporary and permanent, appointed by the court to settle the decedent's probate estate and also the trustee of an inter vivos trust where the trust assets are part of the gross estate for inheritance tax purposes.

The deduction under this category is limited to the fee of the executor or administrator, together with the miscellaneous expenses incurred for settling the Iowa probate estate and the trustee's fees which are attributable to the Iowa trust assets includable for Iowa inheritance tax purposes. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955).

In the case of the fee of a trustee, the amount of the fee deductible under this category is limited to compensation for services rendered the trust commencing with the death of the grantor together with the miscellaneous expenses incurred by the trustee. Trustee fees owed, or the amount of the fee accrued to the day of death, if not the liability of the grantor, constitutes a charge against the trust assets. For administrative convenience it is permissible to deduct fees owing or accrued in the same manner as a debt of the grantor. Fees for the services of a guardian or conservator owed, or accrued to the day of death, are the obligation of the decedent and are properly deductible as a debt of the decedent.

In case any of the assets of the decedent, or grantor of a trust, are the subject of Iowa probate proceedings, the fee and expenses to be deductible must be allowed by order of the court. It is presumed the fee allowed by the court includes compensation for services rendered in connection with both probate and nonprobate property, unless it is shown to the contrary. In case no part of the decedent's or grantor's assets are the subject of Iowa probate proceedings, the fee allowable as a deduction is the fee that would have been allowable had the assets been included in the probate estate (taking into consideration all relevant factors such as the amount of the assets and the time and expense involved in administering nonprobate assets, as distinguished from probate assets).

The deduction for fees to be allowable must be paid, or if not paid at the time the final inheritance tax return is filed, the department must be reasonably satisfied that the fee will be paid.

Iowa Code section 450.12 does not specifically provide that the fee to be allowable must be reasonable. However, since the fee is allowed by order of court and is the same fee allowed under Iowa Code section 633.197, it is an underlying assumption that the deduction is limited to a reasonable fee.

l. Attorney fees. The deduction is for the reasonable fee for legal services, together with the miscellaneous expenses incurred by the attorney, which have been allowed by court order, rendered the administrator, executor or trustee on property includable for Iowa tax purposes. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955). If the attorney fee for services rendered a trustee of Iowa property includable in the gross estate is not allowable because probate proceedings have not been commenced, it is nevertheless deductible as an expense in the same manner as deductible attorney fees incurred for marshaling assets (subject to the same conditions as reasonableness and deductibility as attorney fees allowed in probate proceedings). *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977). If probate proceedings are held on any part of the decedent's assets, it is presumed the fee allowed by the court includes services in connection with both probate and nonprobate property, unless the contrary is shown. See *In re Estate of Simon,* 288 N.W.2d 549 (Iowa 1980) for what constitutes a reasonable fee.

The fee for an attorney employed by the executor, administrator or trustee for the purpose of prosecuting or defending an action for the benefit of the estate or trust as a whole is deductible in the same manner as the attorney fee for settling the estate. The fee of an attorney employed by a person interested in the estate or trust primarily for the purpose of prosecuting or defending a personal interest in the estate or trust is not deductible in computing the net estate. *In re Estate of Law,* 253 Iowa 599, 113 N.W.2d 233 (1962).

The fee to be deductible must be paid, and if not paid at the time the final return is filed, the department must be reasonably satisfied that the fee will be paid.

m. Extraordinary fees. The fee for extraordinary services of the executor, administrator, trustee or attorney allowed by order of court for settling the estate or trust, is deductible in computing the net estate for taxation in the same manner as the fee for ordinary services.

n. Fees—outside specialists. The fees of outside specialists employed by the estate under the provision of Iowa Code section 633.84 such as, but not limited to, surveyors, engineers, accountants and financial advisors are not deductible unless the services are part of the expense of selling real or personal property. Iowa Code section 450.12 only provides for the deduction of those specific items listed in the section. *In re Estate of Waddington,* 201 N.W.2d 77 (Iowa 1972). The fee deduction is limited to the fee of the executor, administrator, trustee and the attorney employed to settle the estate or trust.

o. Fiduciary bond. The expense deductible under this category is limited to the charge of the surety for the executor's or administrator's bond while settling the estate. If a bond is required of the executor or administrator when selling real or personal property of the estate, the charge of the surety is more properly classified as selling expense and is deductible either as court costs or selling expense.

p. Selling expense. The deduction under this category is for the expense of selling real and personal property, and not the expense incurred for the purchase of assets for investment during the administration of the estate or trust. Deductible selling expense specifically includes, but is not limited to, real estate agent's commission, abstract expense, documentary stamps and expense for correcting title to property sold. Items of selling expense, in addition to the expenses specifically enumerated, that may be deductible depending on the facts and circumstances of each individual sale, would include, but are not limited to, the commission of the auctioneer for a public sale, cost of advertising the property for sale, the expense of a clerk for a public auction, necessary expenses of preparation of the property for sale, cost of the deed of conveyance and purchase contract (if the seller's obligation), broker's commission for the sale of personal property and cost of a bond required for selling real or personal property.

The expense deductible is limited to sales by the estate or trust during the period of administration. The expense of a sale by the heirs, beneficiaries, surviving joint tenants and transferees of property for their own benefit is not deductible in computing the net estate for taxation.

Deductible selling expenses must be paid, and if not paid when the final return is filed, the department must be reasonably satisfied that the expense will be paid.

Selling expense is part of court costs. However, for administrative convenience, selling expense should be itemized and listed separately from court costs on the final return.

86.6(3) *Liabilities deductible—nonresident decedents.* For estates of decedents dying prior to July 1, 1983.

a. Liabilities deductible in full. The following items are deductible in full in computing the net estate, subject to the same terms and conditions as like obligations in estates of Iowa-domiciled decedents: Iowa court costs of ancillary administration; the fee of the executor, administrator, trustee and the attorney for settling the Iowa ancillary administration, or the nonprobate assets included in the Iowa gross estate; mortgages or other encumbrances on property includable in the Iowa gross estate; bond of the executor, administrator or trustee in the Iowa ancillary administration; expense of selling Iowa property; and Iowa taxes. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955).

b. Liabilities not deductible. The following items are not deductible in computing the Iowa net estate subject to taxation: court costs of the primary administration and the fees of the executor, administrator, trustee and attorney employed for settling the primary administration outside Iowa; funeral expense if the burial is outside Iowa; appraisal fees incurred in the primary administration; and debts of the decedent and other obligations secured by property with situs outside Iowa which is not includable in the Iowa gross estate, except that if the secured liability is an obligation of the decedent and is in excess of the value of the security, the excess shall be prorated in the same manner as an unsecured debt of the decedent. *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955).

c. Liabilities—to be prorated. The following liabilities are to be prorated between the primary and the ancillary estate: federal income tax owed by the decedent and the federal estate tax imposed on the decedent's estate; unsecured debts of the decedent; and the excess of a debt of the decedent over the value of the property securing the debt, where the security is not includable in the Iowa gross estate.

The amount deductible is computed by multiplying the amount of the liability by a fraction of which the Iowa gross estate is the numerator and the total gross estate is the denominator. However, in the case of federal estate tax, if it is established either by the department or the taxpayer that the taxable estate for federal estate tax purposes includes Iowa property in a greater or lesser proportion than the Iowa property included in federal gross estate, then such greater or lesser proportion shall govern the ratio used in computing the deduction for federal estate taxes paid. See paragraph 86.6(2)*"f."*

86.6(4) *Liabilities deductible—estates of decedents dying on or after July 1, 1983.*

a. In general. Subrules 86.6(1) to 86.6(3) apply to the liabilities deductible in estates of decedents dying on or after July 1, 1983, except as otherwise provided in this subrule.

b. Residents and nonresident distinction abolished. Effective for estates of decedents dying on or after July 1, 1983, the domicile of the decedent is not relevant in determining whether a liability is deductible in computing the net estate. The case of *In re Estate of Evans,* 246 Iowa 893, 68 N.W.2d 289 (1955) only applies to estates of decedents dying prior to July 1, 1983. However, the amount of the liability that is deductible depends upon the situs of the property in the gross estate.

If part of the property included in the gross estate has a situs in a jurisdiction other than Iowa, only a pro rata amount of the liabilities specified in Iowa Code section 450.12, with the exception of liabilities secured by a lien on property, is deductible in computing the net estate for Iowa inheritance tax purposes. The amount deductible is computed by multiplying the total amount of the unsecured liabilities by a fraction of which the Iowa situs property in the gross estate is the numerator and the total gross estate is the denominator. For the purpose of apportionment of the liabilities the term "gross estate" means the gross estate for federal estate tax purposes. Provided, if the federal gross estate formula produces a grossly distorted result then, subject to the approval of the department, an alternate apportionment formula may be used either by the department or the taxpayer which fairly represents the particular facts of the estate.

Liabilities secured by a lien on property are allocated to the state of situs. If the secured liability exceeds the value of the security, any excess is prorated in the same manner as an unsecured liability.

c. Liabilities that must be prorated—estates of decedents dying on or after July 1, 1983. If the gross estate includes property with a situs outside of Iowa, the liabilities that must be prorated are: (1) court costs, both foreign and domestic; (2) unsecured debts of the decedent regardless of where the debt was contracted; (3) federal and state income tax, including the tax on the decedent's final return, federal estate, gift and excise tax, and state and local sales, use and excise tax; (4) expenses of the decedent's funeral and burial, regardless of the place of interment; (5) allowances for the surviving spouse and children allowed by the probate court in Iowa or another jurisdiction; (6) the expense of the appraisal of property for the purpose of assessing a state death or succession tax, if not otherwise included in court costs; (7) the fees and necessary expenses of the personal representative and the personal representative's attorney allowed by order of court, both foreign and domestic; (8) the costs of the sale of real and personal property, both foreign and domestic, if not otherwise included in court costs; and (9) the amount paid by the personal representative for a bond, both foreign and domestic.

d. Liabilities that are not prorated—estates of decedents dying on or after July 1, 1983. Liabilities secured by a lien on property included in the gross estate are to be allocated in full to the state of situs. These are liabilities secured by: (1) mortgages, mechanic's liens and judgments; (2) real estate taxes and special assessments on real property; (3) liens for an obligation to the United States of America, a state or any of its political subdivisions; and (4) any other lien on property imposed by law for the security of an obligation.

e. Accrued taxes—for estates of decedents dying on or after July 1, 1983. Effective for estates of decedents dying on or after July 1, 1983, state and local taxes that have accrued before the decedent's death are deductible in computing the net estate. This modifies paragraph 86.6(2)*"e"* which allows a deduction only for state and local taxes that are due and payable during the fiscal year beginning July 1 in which the decedent's death occurs. In Iowa, property taxes accrue on the date the county board of supervisors makes the tax levy, even though they are not due and payable until the following July 1. *In re Estate of Luke,* 184 N.W.2d 42 (Iowa 1971). Death terminates the decedent's taxable year for income tax purposes. Federal regulation section 1.443-1(a)(2), 701—paragraph 89.4(9)*"b."* As a result, the Iowa tax on the decedent's income for the taxable year ending with the decedent's death is accrued on date of death. In addition, any federal income tax for the decedent's final taxable year is owing at death, even though it is not payable until a later date. Therefore, both the decedent's state and federal income tax, both for prior years and the year of death, are deductible in computing the taxable estate, if unpaid at death.

86.6(5) *Liabilities deductible from property not subject to the payment of debts and charges.* For estates of decedents dying on or after July 1, 1990.

a. Estates with all of the property located in Iowa. Effective for estates of decedents dying on or after July 1, 1990, and subject to the special provisions in 86.6(5), paragraph *"c,"* the liabilities deductible under Iowa Code section 450.12 may be deductible in whole or in part from property includable in the gross estate for inheritance tax purposes which under Iowa debtor-creditor law is not liable for the payment of the debts and charges of the estate under the following terms and conditions:

(1) The application of liabilities.

1. The liabilities must be paid. If a liability is not paid in full, the amount deductible is limited to the amount paid. If the amount claimed is not certified as paid by the time the inheritance tax return is filed, the statute requires that the director must be satisfied that the liabilities, or portions thereof deductible, will be paid.

2. The liability can be deducted only from property that is included in the gross estate for Iowa inheritance tax purposes. This rule would exclude, among others, that portion of joint tenancy property which is excluded from the gross estate, wrongful death proceeds, the first $10,000 in gifts to each donee made within three years of death and property with a situs outside Iowa.

3. The property included in the gross estate that is under Iowa debtor-creditor law subject to the payment of the deductible liabilities must first be applied to the liabilities, and only after this property has been exhausted can the excess liabilities be applied to the other property included in the gross estate.

4. Any excess liabilities remaining unpaid after exhausting the property subject to the payment of the liabilities must be allocated to the remaining property included in the gross estate for inheritance tax purposes on the basis of which the value of each person's share of the other property in the gross estate bears to the total value of the other property included in the gross estate.

(2) General rules.

1. The source of the funds used for payment of the excess liabilities is not relevant to the allowance of the deduction. It is sufficient for the allowance of the deduction that the liability be paid.

2. The applicability of the statute is limited to the deduction for inheritance tax purposes of those liabilities listed in Iowa Code subsection 450.12(1). It neither enlarges nor diminishes the rights of creditors under existing Iowa law.

3. The statute is not limited to estates which are probated and subject to the jurisdiction of the probate court. The statute also applies to estates which file an inheritance tax return for a tax clearance (CIT proceedings) or those otherwise not probated such as, but not limited to, inter vivos trusts whose assets are subject to inheritance tax, estates consisting of joint tenancy with right of survivorship property, estates whose assets consist of transferred property with a reserved life use or interest, estates whose assets consist of gifts made within three years of the decedent's death and estates consisting entirely of qualified terminal interest property (QTIP) in the estate of the surviving spouse.

The statute will apply to any estate when any share of the estate will remain taxable after being reduced by the liabilities in Iowa Code subsection 450.12(1) which are lawfully charged to the share and the deduction of any statutory exemption. Excess liabilities must be prorated over all of the property not subject to debts and charges regardless of whether or not the property is part of a taxable share.

b. Estates with part of the property located outside Iowa. Iowa Code subsection 450.12(2) and 86.6(4)*"b"* require that the liabilities deductible be prorated in those estates where a portion of the property included in the gross estate has a situs outside Iowa. Subject to the special provision in 86.6(5), paragraph *"c,"* in these estates the portion of the liabilities deductible which is allocated to the Iowa property under the proration formula must first be applied to the Iowa situs property which is subject to the payment of the liabilities. Any portion of the liabilities allocated to Iowa remaining unpaid may then be applied to the other Iowa property included in the gross estate subject to the same limitations provided for in 86.6(5)*"a"*(1)"1" to "4."

c. Special rule for liabilities secured by property included in the gross estate. If a liability which is deductible under Iowa Code section 450.12(1)(a) is secured by property included in the gross estate, then the liability is deductible from the specific property that secures the liability, regardless of whether or not the property is subject to the payment of the ordinary debts and charges of the estate. If the liability exceeds the value of the property that secures it and is the obligation of the decedent, then any excess liability is deductible under the same rules that govern unsecured obligations. Examples illustrating this subrule:

EXAMPLE 1

Decedent A, a widow and resident of Iowa, by will left her son, B, 50 percent of her estate and 25 percent to each of her two grandchildren, C and D, children of her deceased daughter E.

The assets and liabilities of the estate are as follows:

Assets		
1. Farm in joint tenancy with her son, B	$160,000	
2. Checking account in decedent's name	$ 3,500	
3. Certificates of deposit in decedent's name	$ 15,000	
4. Series E government bonds in the names of A or grandchild C	$ 20,000	
5. Series E government bonds in the names of A or grandchild D	$ 20,000	
Total gross estate	$218,500	$218,500
Liabilities		
Promissory note owed to bank	$ 15,000	
Doctor bill in excess of insurance	$ 1,500	
Hospital bill in excess of insurance	$ 750	
Utilities	$ 75	
Real estate taxes	$ 4,000	
Attorney fees	$ 4,500	
Credit cards	$ 250	
Funeral bill	$ 4,000	
Total liabilities	$ 30,075	$ 30,075
Net estate		$188,425

Computation of shares

In this estate only the checking account and the certificates of deposit in the amount of $18,500 are subject to the payment of the debts and charges of the estate. The real estate taxes of $4,000 are allocated to the joint tenancy farm.

Property subject to debts and charges	
Bank account and certificates of deposit	$ 18,500
$4,000 of the joint tenancy real estate for taxes	$ 4,000
Total	$ 22,500
Property not subject to debts and charges	
Joint tenancy real estate ($160,000 — $4,000 taxes)	$156,000
Series E U.S. bonds	$ 40,000
Total	$196,000
Liabilities	
To be paid from property subject to debts	$ 22,500
To be prorated from property not subject to debts and charges	$ 7,575
Total liabilities	$ 30,075

Each Beneficiary's Share of Liabilities To Be Paid From Joint Property
Property not subject to debts and charges:

B's share $\frac{156,000}{196,000} = 79.60\%$

C's share $\frac{20,000}{196,000} = 10.20\%$

D's share same as C $= \frac{10.20\%}{100\%}$

Computation of net shares of estate

Son B			
Gross share			
Farm in joint tenancy	$160,000		
50% of checking account & CDs	$ 9,250		
		$169,250.00	
Less liabilities			
Liability allocated to property subject to debts	$ 9,250.00		
Real estate taxes	$ 4,000.00		
Excess liabilities (79.60% of $7,575)	$ 6,029.70		
Total Liabilities	$19,279.70	$ 19,279.70	
Net share			$149,970.30
Grandchild C			
Gross share			
Series E bonds in joint tenancy	$ 20,000.00		
25% checking account & CDs	$ 4,625.00		
		$ 24,625.00	
Less liabilities			
Liabilities allocated to property subject to debts	$ 4,625.00		
Excess liabilities (10.20% of $7,575.00)	$ 772.65		
	$ 5,397.65	$ 5,397.65	
Net share			$ 19,227.35
Grandchild D			
Same as Grandchild C			$ 19,227.35
Total Shares			$188,425.00

EXAMPLE 2

Decedent A, a widower and resident of Dickinson County, Iowa, died testate, leaving his estate in equal shares to his two children, B and C.

Assets	
160-acre farm owned by the decedent in Minnesota	$160,000
Residence in Milford, Iowa, in joint tenancy with children	$ 50,000
Checking account - decedent owned	$ 1,500
Certificate of deposit - decedent owned	$ 1,000
Total Assets (Iowa $52,500, Minnesota $160,000)	$212,500

Liabilities	
Attorney and fiduciary fees, Minnesota	$ 6,680
Court costs, Minnesota	$ 500
Attorney fees, Iowa	$ 750
Iowa court costs	$ 150
Funeral bill	$ 3,500
Miscellaneous unsecured debts	$ 1,000
Total Liabilities	$ 12,580

Proration of the liabilities between Iowa and Minnesota under Iowa Code section 450.12(2) and subrule 86.6(4).

$$\frac{\text{Iowa Gross } 52{,}500}{\text{Total Gross } 212{,}500} = 24.71\% \times \$12{,}580 = \$3{,}108$$

In this example the liabilities allocated to the Iowa estate in the amount of $3,108 exceed the $2,500 in Iowa property subject to debts and charges. The excess debts and charges of $608 are deductible from the children's joint tenancy property for inheritance tax purposes even though there is sufficient Minnesota property which is subject to debts and charges. To take the excess Iowa debts and charges from the Minnesota property would allocate more liabilities to Minnesota than Iowa Code section 450.12(2) allows.

Computation of Shares — Iowa Estate

Child B

Assets	**Liabilities**	**Net Share**
½ joint tenancy house $25,000	½ excess liabilities $304	$24,696
½ checking account $750	Less $750 for debts	0
½ certificate of deposit $500	Less $500 for debts	0
Total Net Share		$24,696
Child C — Same as Child B		$24,696
		$49,392

Recap

Total Iowa Gross	$52,500
Less Iowa Liabilities	3,108
Iowa Net Estate	$49,392

EXAMPLE 3

Decedent A, a widow, died intestate in a nursing home, a resident of Iowa. The assets of her estate consisted of $100,000 in stocks and bonds held in joint tenancy with her only child, B, and $10,000 Series E U.S. savings bonds registered in equal amounts in joint tenancy with her grandchildren, C and D. A also owned at death a checking account with the amount of $5,000 registered in her name alone. The debts and charges in the estate were $10,000.

In this estate, the $5,000 checking account was applied against the $10,000 debts and charges. The decedent's son, B, paid the remaining debts and charges of $5,000 from his personal funds. Since the grandchildren's exemption of $15,000 is in excess of each grandchild's inheritance of $5,000, allocating 9.09 percent of the excess debts and charges against their joint tenancy U.S. bonds confers no tax benefit on the grandchildren. Under this set of facts, son B is not permitted to deduct from his joint property all of the excess debts and charges in the amount of $5,000 he paid. The statute only permits him to deduct his protestor rata share (90.91 percent of $5,000 or $4,545.45) even though he paid all of the excess deductions. The surviving joint tenants are not permitted to choose which joint tenants will receive the benefit of the excess deductions. The statute requires that the deductions be prorated.

86.6(6) *Liabilities deductible—estates of decedents who died on or after July 1, 1995.* Subject to 701—86.6(4) and 701—86.6(5), the only liabilities deductible from the gross value of the estate include debts owing by the decedent at the time of death, local and state taxes accrued before the decedent's death, federal estate tax and federal taxes owing by the decedent, a sum for reasonable funeral expenses, the allowance for surviving spouse and minor children granted by the probate court or its judge, court costs, and any other administration expenses allowable pursuant to Section 2053 of the Internal Revenue Code.

a. Criteria for deductible administration expenses under Section 2053 of the Internal Revenue Code. Administration expenses must meet certain requirements to be allowable deductions under Section 2053 of the Internal Revenue Code. To be allowable deductions, expenses must meet the following conditions:

(1) The expenses must be payable out of property subject to claims;

(2) The expenses are allowable (not based on the deductible amount) by the law governing the administration of the decedent's estate;

(3) The expenses are actually and necessarily incurred in the administration of the estate. Administration expenses are limited to those expenses incurred in the settlement of the estate and the transfer of the estate property to beneficiaries and trustees, including an executor that is a trustee. Expenses that are not essential to the settlement of the estate, but are incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions; and

(4) The allowable amount of expenses for deduction is limited to the value of property included in the decedent's gross estate and subject to claims, plus amounts paid out of the property not subject to claims against the decedent's estate, on or before the last day of the ninth month after death or within any granted extension(s) of time for filing the return. "Property subject to claims" is defined as the property includable in the gross estate which bears the burden or would bear the burden under law for payment of the deduction in the final adjustment and settlement of the decedent's estate, less an initial deduction allowable under Section 2054 of the Internal Revenue Code, for any losses for casualty or theft attributable to such property and incurred during the settlement of the estate.

b. Allowable administration expenses. Subject to the limitations in paragraph *"a"* of this subrule, allowable administration expenses under Section 2053 of the Internal Revenue Code include costs and fees incurred in the collection of assets, payment of debts, distribution of property to entitled persons, executor's commission, attorney's fees and miscellaneous administration expenses. Miscellaneous administration expenses include costs or fees for surrogates, accountants, appraisers, clerk hire, storing or maintaining property of the estate, and selling the property of the estate. Expenses for preserving and caring for the property do not include expenditures for additions or improvements or expenses for a longer period than the executor is reasonably required to retain the property. Expenses for selling property of the estate are limited to those for sales that are necessary in order to pay the decedent's debts, expenses of administration, and taxes, preserve the estate, or effect distribution. Expenses for selling the property include brokerage fees or auctioneer fees, and may include the expenses for a sale of an item in a bona fide sale that is below the fair market value of the item. The allowable selling expense for an item sold below its fair market value to a dealer in such items is the lesser of the amount by which the fair market value of the item on the valuation date exceeded the proceeds from the sale or the amount by which the fair market value of the item on the date of the sale exceeded the proceeds of the sale.

This rule is intended to implement Iowa Code sections 450.7(1), 450.12, 450.22, 450.24, 450.38, 450.89, 633.278, and 633.374.

701—86.7(450) Life estate, remainder and annuity tables—in general. For estates of decedents dying on or after July 4, 1965, and prior to January 1, 1986, the value of a life estate in property, an annuity for life and the value of a remainder interest in the property, shall be computed by the use of the commissioners' standard ordinary mortality table at the rate of 4 percent per annum.

86.7(1) *Tables for life estates and remainders.* This subrule only applies to estates of decedents dying on or after July 4, 1965, and prior to January 1, 1986. The two factors on the same line on the next page added together equal 100 percent. Multiply the corpus of the estate by the first factor to obtain the value of the life estate. Use the second factor to obtain the value of the remainder interest in the corpus if the tax is to be paid within 12 months after the death of the decedent who created the life estate remainder. If the tax on the remainder is to be paid prior to the death of the life tenant, but after one year from the decedent's death, use the remainder factor opposite the age of the life tenant at the time the tax is to be paid.

Age of Life Tenant	Life Estate	Remainder
0	.90164	.09836
1	.89936	.10064
2	.89900	.10100
3	.89676	.10324
4	.89396	.10604
5	.89104	.10896
6	.88792	.11208
7	.88464	.11536
8	.88120	.11880
9	.87756	.12244
10	.87380	.12620
11	.86984	.13016
12	.86576	.13424
13	.86152	.13848
14	.85716	.14284
15	.85268	.14732
16	.84808	.15192
17	.84336	.15664
18	.83852	.16148
19	.83356	.16644
20	.82840	.17160
21	.82308	.17692
22	.81756	.18244
23	.81184	.18816
24	.80592	.19408
25	.79976	.20024

Age of Life Tenant	Life Estate	Remainder
26	.79336	.20664
27	.78672	.21328
28	.77984	.22016
29	.77268	.22732
30	.76524	.23476
31	.75756	.24244
32	.74960	.25040
33	.74132	.25868
34	.73280	.26720
35	.72392	.27608
36	.71476	.28524
37	.70532	.29468
38	.69560	.30440
39	.68560	.31440
40	.67536	.32464
41	.66488	.33512
42	.65412	.34588
43	.64316	.35684
44	.63192	.36808
45	.62044	.37956
46	.60872	.39128
47	.59680	.40320
48	.58464	.41536
49	.57228	.42772
50	.55972	.44028
51	.54700	.45300
52	.53412	.46588
53	.52104	.47896
54	.50788	.49212
55	.49452	.50548
56	.48108	.51892
57	.46756	.53244
58	.45392	.54608
59	.44024	.55976
60	.42652	.57348

Age of Life Tenant	Life Estate	Remainder
61	.41280	.58720
62	.39908	.60092
63	.38538	.61462
64	.37174	.62826
65	.35817	.64183
66	.34471	.65529
67	.33140	.66860
68	.31829	.68171
69	.30542	.69458
70	.29282	.70718
71	.28048	.71952
72	.26840	.73160
73	.25653	.74347
74	.24481	.75519
75	.23322	.76678
76	.22175	.77825
77	.21045	.78955
78	.19938	.80062
79	.18863	.81137
80	.17826	.82174
81	.16830	.83170
82	.15876	.84124
83	.14960	.85040
84	.14078	.85922
85	.13224	.86776
86	.12395	.87605
87	.11584	.88416
88	.10785	.89215
89	.09990	.90010
90	.09192	.90808
91	.08386	.91614
92	.07563	.92437
93	.06715	.93285
94	.05826	.94174
95	.04866	.95134

Age of Life Tenant	Life Estate	Remainder
96	.03801	.96199
97	.02595	.97405
98	.01275	.98725
99	.00000	1.00000

86.7(2) *Table for an annuity for life.* This subrule only applies to estates of decedents dying on or after July 4, 1965, and prior to January 1, 1986. To find the present value of an annuity or a given amount (specified sum) for life, annualize the annuity payments and multiply the result by the annuity factor in Column 3 opposite the age at the nearest birthday of the person receiving the annuity.

Column 1 Age in Years	Column 2 Life Expectancy in Years	Column 3 4% Annuities $1.00
0	68.30	22.541
1	67.78	22.484
2	66.90	22.475
3	66.00	22.419
4	65.10	22.349
5	64.19	22.276
6	63.27	22.198
7	62.35	22.116
8	61.43	22.030
9	60.51	21.939
10	59.58	21.845
11	58.65	21.746
12	57.72	21.644
13	56.80	21.538
14	55.87	21.429
15	54.95	21.317
16	54.03	21.202
17	53.11	21.084
18	52.19	20.963
19	51.28	20.839
20	50.37	20.710
21	49.46	20.577
22	48.55	20.439
23	47.64	20.296
24	46.73	20.148
25	45.82	19.994

Column 1 Age in Years	Column 2 Life Expectancy in Years	Column 3 4% Annuities $1.00
26	44.90	19.834
27	43.99	19.668
28	43.08	19.496
29	42.16	19.317
30	41.25	19.131
31	40.34	18.939
32	39.43	18.740
33	38.51	18.533
34	37.60	18.320
35	36.69	18.098
36	35.78	17.869
37	34.88	17.633
38	33.97	17.390
39	33.07	17.140
40	32.18	16.884
41	31.29	16.622
42	30.41	16.353
43	29.54	16.079
44	28.67	15.798
45	27.81	15.511
46	26.95	15.218
47	26.11	14.920
48	25.27	14.616
49	24.45	14.307
50	23.63	13.993
51	22.82	13.675
52	22.03	13.353
53	21.25	13.026
54	20.47	12.697
55	19.71	12.363
56	18.97	12.027
57	18.23	11.689
58	17.51	11.348
59	16.81	11.006
60	16.12	10.663

Column 1 Age in Years	Column 2 Life Expectancy in Years	Column 3 4% Annuities $1.00
61	15.44	10.320
62	14.78	9.9770
63	14.14	9.6346
64	13.51	9.2935
65	12.90	8.9543
66	12.31	8.6178
67	11.73	8.2851
68	11.17	7.9572
69	10.64	7.6355
70	10.12	7.3204
71	9.63	7.0121
72	9.15	6.7101
73	8.69	6.4133
74	8.24	6.1203
75	7.81	5.8304
76	7.39	5.5437
77	6.98	5.2612
78	6.59	4.9845
79	6.21	4.7158
80	5.85	4.4566
81	5.51	4.2076
82	5.19	3.9689
83	4.89	3.7399
84	4.60	3.5194
85	4.32	3.3061
86	4.06	3.0988
87	3.80	2.8961
88	3.55	2.6963
89	3.31	2.4975
90	3.06	2.2981

Column 1 Age in Years	Column 2 Life Expectancy in Years	Column 3 4% Annuities $1.00
91	2.82	2.0965
92	2.58	1.8907
93	2.33	1.6787
94	2.07	1.4564
95	1.80	1.2166
96	1.51	.9503
97	1.18	.6487
98	.83	.3189
99	.50	.0000

86.7(3) *Annuity tables when the term is certain.* This table is to be used to compute the present values of two types of annuities: (1) the use of property for a specific number of years and (2) an annuity of a specific amount of money for a number of years certain. To compute the present value of the first annuity, multiply the value of property by 4 percent. Then multiply the result by the annuity factor opposite the number of years of the annuity. Multiply the value of the property by the remainder factor for the present value of the remainder. For the second annuity annualize the payments and multiply the result by the annuity factor opposite the number of years of the annuity. Subtract the present value of the annuity from the value of the property from which the annuity is funded for the remainder value.

Number of Years	Present Value of an Annuity of One Dollar, Payable at the End of Each Year, for a Certain No. of Years ANNUITY	Present Value of One Dollar, Payable at the End of a Certain Number of Years REMAINDER
1	$0.96154	$0.961538
2	1.88609	0.924556
3	2.77509	0.888996
4	3.62990	0.854804
5	4.45182	0.821927
6	5.24214	0.790315
7	6.00205	0.759918
8	6.73274	0.730690
9	7.43533	0.702587
10	8.11090	0.675564
11	8.76048	0.649581
12	9.38507	0.624597
13	9.98565	0.600574
14	10.56312	0.577475
15	11.11839	0.555265

Number of Years	Present Value of an Annuity of One Dollar, Payable at the End of Each Year, for a Certain No. of Years	Present Value of One Dollar, Payable at the End of a Certain Number of Years
	ANNUITY	REMAINDER
16	$11.65230	$0.533908
17	12.16567	0.513373
18	12.65930	0.493628
19	13.13394	0.474642
20	13.59033	0.456387
21	14.02916	0.438834
22	14.45112	0.421955
23	14.85684	0.405726
24	15.24696	0.390121
25	15.62208	0.375117
26	15.98277	0.360689
27	16.32959	0.346817
28	16.66306	0.333477
29	16.98371	0.320651
30	17.29203	0.308319

86.7(4) *Tables for life estates and remainders for estates of decedents dying on or after January 1, 1986.* For estates of decedents dying on or after January 1, 1986, the following tables are to be used in computing the value of a life estate, an annuity for life and the value of a remainder in property. The table is based on the commissioners' standard ordinary mortality tables of life expectancy, with no distinction being made between the life expectancy of males and females of the same age. As a result the sex of the recipient is not relevant in computing the value of the property interest received. *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris,* 463 U.S. 1073, 103 S.Ct. 3492, 77 L.Ed.2d 1236 (1983). The following tables are to be applied in the same manner as specified in subrule 86.7(1).

1980 CSO-D MORTALITY TABLE
BASED ON BLENDING 50% MALE—50% FEMALE
(PIVOTAL AGE 45)
AGE NEAREST BIRTHDAY
4% INTEREST

AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER	AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER
0	.91904	.08096	50	.61730	.38270
1	.91919	.08081	51	.60576	.39424
2	.91689	.08311	52	.59399	.40601
3	.91443	.08557	53	.58199	.41801
4	.91186	.08814	54	.56979	.43021
5	.90914	.09086	55	.55740	.44260
6	.90629	.09371	56	.54483	.45517
7	.90329	.09671	57	.53206	.46794
8	.90014	.09986	58	.51906	.48094
9	.89683	.10317	59	.50582	.49418
10	.89338	.10662	60	.49234	.50766
11	.88977	.11023	61	.47862	.52138
12	.88603	.11397	62	.46471	.53529
13	.88219	.11781	63	.45064	.54936
14	.87828	.12172	64	.43647	.56353
15	.87429	.12571	65	.42226	.57774
16	.87027	.12973	66	.40801	.59199
17	.86617	.13383	67	.39372	.60628
18	.86200	.13800	68	.37936	.62064
19	.85773	.14227	69	.36489	.63511
20	.85333	.14667	70	.35031	.64969
21	.84878	.15122	71	.33565	.66435
22	.84404	.15596	72	.32098	.67902
23	.83912	.16088	73	.30639	.69361
24	.83399	.16601	74	.29199	.70801
25	.82865	.17135	75	.27787	.72213
26	.82306	.17694	76	.26405	.73595
27	.81724	.18276	77	.25053	.74947
28	.81117	.18883	78	.23727	.76273
29	.80487	.19513	79	.22422	.77578
30	.79833	.20167	80	.21134	.78866
31	.79155	.20845	81	.19866	.80134
32	.78451	.21549	82	.18625	.81375
33	.77723	.22277	83	.17419	.82581
34	.76970	.23030	84	.16260	.83740
35	.76192	.23808	85	.15151	.84849
36	.75389	.24611	86	.14093	.85907

AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER	AGE OF LIFE TENANT	LIFE ESTATE	REMAINDER
37	.74562	.25438	87	.13081	.86919
38	.73710	.26290	88	.12108	.87892
39	.72836	.27164	89	.11163	.88837
40	.71940	.28060	90	.10235	.89765
41	.71022	.28978	91	.09309	.90691
42	.70083	.29917	92	.08368	.91632
43	.69122	.30878	93	.07390	.92610
44	.68138	.31862	94	.06350	.93650
45	.67131	.32869	95	.05221	.94779
46	.66101	.33899	96	.03994	.96006
47	.65046	.34954	97	.02678	.97322
48	.63966	.36034	98	.01321	.98679
49	.62860	.37140	99	.00000	1.00000

86.7(5) *Table for an annuity for life—for estates of decedents dying on or after January 1, 1986.* The following table is to be used in computing the present value of an annuity of a given amount (specified sum) for life in estates of decedents dying on or after January 1, 1986. The table is to be used in the same manner as the table listed in subrule 86.7(2).

1980 CSO-D MORTALITY TABLE
BASED ON BLENDING 50% MALE—50% FEMALE
(PIVOTAL AGE 45)
AGE NEAREST BIRTHDAY
4% INTEREST

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00	AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
0	73.30	22.976	50	27.45	15.433
1	72.56	22.980	51	26.61	15.144
2	71.63	22.922	52	25.77	14.850
3	70.70	22.861	53	24.94	14.550
4	69.76	22.796	54	24.13	14.245
5	68.82	22.728	55	23.32	13.935
6	67.87	22.657	56	22.52	13.621
7	66.93	22.582	57	21.73	13.301
8	65.98	22.504	58	20.95	12.976
9	65.03	22.421	59	20.18	12.645
10	64.07	22.334	60	19.41	12.308
11	63.12	22.244	61	18.66	11.966
12	62.16	22.151	62	17.91	11.618
13	61.21	22.055	63	17.18	11.266
14	60.27	21.957	64	16.45	10.912
15	59.32	21.857	65	15.75	10.557

AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00	AGE IN YEARS	LIFE EXPECTANCY IN YEARS	ANNUITIES $1.00
16	58.39	21.757	66	15.05	10.200
17	57.46	21.654	67	14.38	9.843
18	56.53	21.550	68	13.71	9.484
19	55.61	21.443	69	13.06	9.122
20	54.69	21.333	70	12.42	8.758
21	53.77	21.219	71	11.79	8.391
22	52.85	21.101	72	11.17	8.024
23	51.93	20.978	73	10.57	7.660
24	51.01	20.850	74	10.00	7.300
25	50.08	20.716	75	9.44	6.947
26	49.15	20.576	76	8.91	6.601
27	48.23	20.431	77	8.39	6.263
28	47.30	20.279	78	7.90	5.932
29	46.36	20.122	79	7.42	5.605
30	45.43	19.958	80	6.96	5.283
31	44.50	19.789	81	6.52	4.967
32	43.57	19.613	82	6.09	4.656
33	42.64	19.431	83	5.68	4.355
34	41.72	19.242	84	5.29	4.065
35	40.79	19.048	85	4.93	3.788
36	39.87	18.847	86	4.58	3.523
37	38.94	18.640	87	4.26	3.270
38	38.03	18.428	88	3.95	3.027
39	37.11	18.209	89	3.66	2.791
40	36.21	17.985	90	3.37	2.559
41	35.30	17.756	91	3.09	2.327
42	34.41	17.521	92	2.81	2.092
43	33.52	17.280	93	2.52	1.848
44	32.63	17.035	94	2.22	1.588
45	31.75	16.783	95	1.90	1.305
46	30.88	16.525	96	1.56	.999
47	30.01	16.261	97	1.20	.670
48	29.15	15.991	98	.84	.330
49	28.30	15.715	99	.50	.000

This rule is intended to implement Iowa Code sections 450.51 and 450.52.

701—86.8(450B) Special use valuation.

86.8(1) *In general.* Effective for estates of decedents dying on or after July 1, 1982, real estate which has been valued at its special use value under 26 U.S.C. Section 2023A for computing the federal estate tax, is eligible to be valued for inheritance tax purposes at its special use value, subject to the limitations imposed by statute and these rules. Special use valuation under the provisions of Iowa Code chapter 450B is in lieu of valuing the real estate at its fair market value in the ordinary course of trade under Iowa Code sections 450.37 and 450.39. The valuation of real estate at its special use value must be made on the entire parcel of the real estate in fee simple. The value of undivided interests, life or term estates and remainders in real estate specially valued, is determined by (1) applying the life estate, remainder or term tables to the special use value, or (2) by dividing the special use value by the decedent's fractional interest in case of an undivided interest. The eligibility of real estate for special use value is not limited to probate real estate. Real estate transfers with a retained life use or interest, real estate held in joint tenancy, real estate transferred to take effect in possession or enjoyment at death, and real estate held in trust are noninclusive examples of real estate not subject to probate that may be eligible for special use valuation.

86.8(2) *Definitions and technical terms.* Reference in this subrule to sections of the Internal Revenue Code mean sections of the Internal Revenue Code of 1954 as defined (and periodically updated) in Iowa Code section 422.4. Technical terms such as, but not limited to, "qualified real property"; "qualified use"; "cessation of qualified use"; "disposition"; "qualified heir"; "member of the family"; "farm"; "farming purpose"; "material participation"; and "active management" are examples of technical terms which have the same meaning for Iowa special use valuation under Iowa Code chapter 450B as the terms are defined and interpreted in 26 U.S.C. Section 203A. It is the purpose of Iowa special use valuation to conform as nearly as possible to the special use valuation provisions of 26 U.S.C. Section 2032A, as can be done within the framework of an inheritance tax instead of an estate tax.

86.8(3) *Eligibility requirements*. The eligibility requirements for valuing real estate at its special use value for computing inheritance tax are the same as the eligibility requirements of 26 U.S.C. Section 2032A for the purpose of computing the federal estate tax imposed by 26 U.S.C. Section 2001. Real estate cannot be specially valued for inheritance tax purposes unless it is also eligible and is valued at its special use value for federal estate tax purposes. However, even though real estate is specially valued for federal estate tax purposes, the estate has the right to elect or not to elect to value real estate at its special use value for computing the inheritance tax. Real estate otherwise qualified will be eligible for special use valuation for Iowa inheritance tax purposes if a valid special use valuation election has been made on the federal estate tax return. What constitutes a valid election for federal estate tax purposes is determined under applicable federal law and practice and is not determined by the department.

86.8(4) *Real estate—not eligible.*

a. Real estate otherwise qualified is not eligible to be specially valued for inheritance tax purposes if it is not includable in the federal gross estate. For example, real estate subject to a special power of appointment is includable in the gross estate of the donee for inheritance tax purposes, if the power is exercised, but it is not includable in the gross estate for federal estate tax purposes unless a qualified terminable interest property (QTIP) election is made in the donor's estate. In this case, the real estate is not eligible to be valued at its special use value, though it might otherwise be qualified. See 86.5(10)*"d"* regarding an exercise of a power of appointment. Also, *Kurtz on Iowa Estates,* section 23.9, page 1083.

b. Real estate, otherwise qualified, will not be eligible for the special use valuation provisions of Iowa Code chapter 450B, if the owner of a remainder, or other future property interest in the real estate, defers the payment of the inheritance tax until the termination of the prior estate. Special use valuation is made at the date of the decedent's death, while Iowa Code section 450.44 requires the future interest to be revalued at the time of the termination of the prior estate when the tax is deferred. See *In re Estate of Wickham*, 241 Iowa 198, 40 N.W.2d 469 (1950); department subrules 86.2(12) and 86.2(13). In addition, when the tax has been deferred the life estate-remainder factor to be used in computing the tax on the future interest is the factor existing at the time of payment or the termination of the prior estate, while the additional inheritance tax under special use value is based on the life estate-remainder factor at the time of death. See *In re Estate of Millard*, 251 Iowa 1982, 105 N.W.2d 95 (1960). A second valuation after death is not within the scope of either 26 U.S.C. Section 2032A or Iowa Code chapter 450B. Since all persons with an interest in the real estate must sign the agreement specified in 86.8(5)*"d,"* the deferral of the inheritance tax on a future property interest disqualifies all of the property interests in the real estate because the future property interest is not eligible to be specially valued in case of a deferral of the tax.

86.8(5) *Election and agreement*.

a. In general. The election to specially value real estate under the provisions of Iowa Code chapter 450B must be made by the fiduciary for the estate or trust on the final inheritance tax return or on a statement attached to the return. The election may be made on a delinquent return. However, once made, the election is irrevocable. The election is an affirmative act. Therefore, failure to make an election on the final inheritance tax return shall be construed as an election not to specially value real estate under Iowa Code chapter 450B.

b. Form—election. The election to value real estate at its special use value shall comply with the requirements of 26 U.S.C. Section 2032A(d) and federal regulation Section 20.2032A-8. An executed copy of the election filed with the federal estate tax return and accepted by the Internal Revenue Service will fulfill the requirements of this subrule.

c. Content of the election. The election must be accompanied by the agreement specified in 86.8(5)*"d"* and shall contain the information required by federal regulation 20.2032A-8. Submission of an executed copy of the information required by federal regulation Section 20.2032A-8(3) in support of the election to specially value property for federal estate tax purposes, will fulfill the requirements of this subrule.

d. Protective elections. A protective election may be made to specially value qualified real property for inheritance tax purposes. The availability of special use valuation is contingent upon values, as finally determined for federal estate tax purposes, meeting the requirements of 26 U.S.C. Section 2032A. The protective election must be made on the final inheritance tax return and shall contain substantially the same information required by federal regulation section 20.2032A-8(b). Submission of an executed copy of the protective election filed and accepted for federal estate tax purposes will fulfill the requirements of this subrule.

If it is found that the real estate qualifies for special use valuation as finally determined for federal estate tax purposes, an additional notice of election must be filed within 60 days after the date of the determination. The notice must set forth the information required in 86.8(5)*"c"* and is to be attached, together with the agreement provided for in 86.8(5)*"d,"* to an amended final inheritance tax return. Failure to file the additional notice within the time prescribed by this subrule shall disqualify the real estate for special use valuation.

e. Agreement. An agreement must be executed by all parties who have any interest in the property to be valued at its special use value as of the date of the decedent's death. In the agreement, the qualified heir must consent to personal liability for the additional inheritance tax imposed by Iowa Code section 450B.4 in the event of early disposition or cessation of the qualified use. All other parties with an interest in the property specially valued must consent to liability for the additional inheritance tax to the extent of the additional tax imposed on their share of the property no longer eligible to be specially valued. The liability of the qualified heir or the successor qualified heir for the additional inheritance tax is not dependent on the heir's share of the property specially valued, but rather it is for the amount of the additional inheritance tax imposed on all of the shares of the parties with an interest in the property no longer eligible for special use value.

f. Failure to file the election and agreement. Failure to file with the final inheritance tax return either the election provided for in 86.8(5)*"b"* or the agreement specified in 86.8(5)*"e"* shall disqualify the property for the special use value provisions of Iowa Code chapter 450B. In the event of disqualification, the property shall be valued for inheritance purposes at its market value in the ordinary course of trade under the provisions of Iowa Code sections 450.37 and 450.39.

86.8(6) *Value to use.*

a. Special use value. The special use value established and accepted by the Internal Revenue Service for the qualified real property shall also be the value of the qualified real property for the purpose of computing the inheritance tax on the shares in the specially valued property. In the event the property interests in the specially valued real property are taxed for inheritance tax purposes as a life or term estate with a remainder over, the value of the life or term estate and the remainder are valued by applying the appropriate life estate-remainder or term tables in rule 86.7(450) to the special use value of the qualified real property.

b. Fair market value when a recapture tax is imposed. The additional inheritance tax imposed by Iowa Code section 450B.4, due to the early disposition or cessation of the qualified use, is based on the fair market value of the qualified real property at the time of the decedent's death as reported and established in the election to value the real estate at its special use value, subject to the limitations in 86.8(6)*"c."* Iowa Code chapter 450B makes reference only to the use of federal values. Therefore, a fair market value appraisal made by the Iowa inheritance tax appraisers cannot be used in computing the amount of the additional inheritance tax imposed unless it is accepted by the Internal Revenue Service. Iowa Code section 450.27 only applies to property which is not specially valued under Iowa Code chapter 450B.

c. Fair market value limitations. The following fair market value limitations shall govern the computation of the additional inheritance tax imposed, if any. If at the time of its disposition or cessation of the qualified use, the fair market value of the property which is the subject of the additional tax is:

1. Greater than its fair market value at the time of the decedent's death, the additional tax is computed on the fair market value at death.

2. Less than its fair market value at the time of death but greater than the special use value, the additional tax is computed on the lesser fair market value.

3. Equal to or less than the special use value of the property, no additional inheritance tax is imposed. In this event, no refund is allowed. Iowa Code chapter 450B makes reference only to the imposition of additional inheritance tax, not to an additional benefit if the agreement is not fulfilled.

As a result, failure to fulfill the agreement provided for in 86.8(5)*"d"* may, in certain circumstances, result in a lower tax liability than would have been the case had the special use valuation election not been made.

The rule for computing the additional federal estate tax under 26 U.S.C. Section 2032A(c) is different. See lines 8 to 11, Additional Federal Estate Tax Form 706-A and IRS letter ruling 8215036 (1982).

86.8(7) *Imposition of additional inheritance tax.*

a. In general. If within ten years after the decedent's death there is a disposition of the property or a cessation of the qualified use within the meaning of 26 U.S.C. Section 2032A(c), an additional inheritance tax is imposed on the shares in the qualified real property specially valued, subject to the limitation in 86.8(6)*"c,"* "3." Failure to begin the special use within two years after the decedent's death disqualifies the property for the special use valuation provisions of Iowa Code chapter 450B. However, the ten-year period for imposing an additional inheritance tax is not extended by the period of time between the decedent's death and the beginning date of the special use. The rule for federal estate tax purposes is different. The ten-year period for federal estate tax purposes is extended by the period of time between the decedent's death and the time the special use begins. See 26 U.S.C. Section 2032A(c)(7)(A)(ii). In this respect the Iowa law does not conform to the federal statute. See Iowa Code section 450B.3.

b. Additional tax on life or term estates and remainders. The additional tax on life or term estates and remainders in real estate which no longer qualifies for special use valuation, is computed as if the special use valuation had not been elected. Therefore, if age or time is a determining factor in computing the additional tax, it is the age or time at the date of the decedent's death which governs the computation, not the age or time at the date of the disposition or cessation of the qualified use. Therefore, subrules 86.2(12) and 86.2(13) implementing Iowa Code section 450.44 do not apply. Iowa Code section 450B.3 makes no provision for deferral of the additional tax on a future property interest in real estate which is no longer eligible to be specially valued.

c. Interplay of the additional inheritance tax with the Iowa estate tax. In the event of an early disposition or cessation of the qualified use of the specially valued real estate, the federal estate tax is recomputed with a corresponding recomputation of the credit allowable under 26 U.S.C. Section 2011 for state death taxes paid. If the maximum allowable credit for state death taxes paid as recomputed is greater than the total inheritance tax obligation on all of the shares of the estate, including the shares which have not been revalued, the amount of the maximum credit for state death taxes paid is the additional tax. See Iowa Code section 451.2.

EXAMPLE. When the Iowa estate tax is the additional tax due. Farmer A died testate July 1, 1982, a resident of Iowa, survived by a spouse, B, and two children, C and D. Child C farmed the family farm. The will provided for the surviving spouse to receive all of the personal property and a life estate in the real estate, with remainder over to the two children. The surviving spouse did not elect to qualify the life estate-remainder as marital deduction property. The surviving spouse was 74 years old on July 1, 1982. The decedent's estate consisted of the following:

Asset	Fair Market Value	Special Use Value
240-acre Iowa farm	$600,000 (240 × $2,500 per acre)	$228,000 ($950 per acre)
Grain & livestock	40,000	40,000
Stocks, bonds & bank accounts	35,000	35,000
Gross Estate	$675,000	$303,000
Less: Deductions without federal estate tax	30,000	30,000
Net estate before federal estate tax	$645,000	$273,000

COMPUTATION OF THE INHERITANCE TAX
UNDER SPECIAL USE VALUATION

Net estate before federal estate tax	$273,000
Less: Federal estate tax: see note	0
Net estate	$273,000

NOTE: $75,000 qualified for the marital deduction. The debts and charges are deductible from the children's share under the law of abatement. See *In re Estate of Noe,* 195 N.W.2d 361 (Iowa 1972).

TAX ON SHARES

Beneficiary	Share	Tax
Spouse B		
Grain & livestock	$ 40,000.00	
Stocks & bonds, bank accounts	35,000.00	
Total personal property	$ 75,000.00	
Life estate in farm (.24481 × 228,000)	55,816.68	
Total Share	$130,816.68	$ 166.33
Child C		
½ remainder $\frac{(228{,}000 \times .75519)}{2}$	$ 86,091.66	
Less: ½ debts & charges	15,000.00	
Net share	$ 71,091.66	$ 457.75
Child D		
Same as Child C	$ 71,091.66	$ 457.75
Total Shares & Tax	$273,000.00	$1,081.83

On October 15, 1985, the surviving spouse and the two children, due to adverse economic conditions, sell the farm to a nonrelated party for $2,100 per acre or $504,000. Under 86.8(6)*"c,"* the $2,100 per acre valuation, rather than the $2,500 per acre, governs the computation of the additional tax. This example illustrates the point that the credit for state death taxes paid will be the additional tax in many cases.

COMPUTATION OF THE ADDITIONAL INHERITANCE TAX DUE TO THE EARLY DISPOSITION OF THE QUALIFIED USE PROPERTY

Assets		
240-acre Iowa farm ($2,100 per acre × 240)		$504,000
Livestock & grain		40,000
Stocks, bonds & bank accounts		35,000
Gross Estate		$579,000
Less: Deductions without federal estate tax	$ 30,000	
Add'l federal estate tax ($118,900 less $12,800 credit for state taxes paid)	106,100	136,100
Net Estate		$442,900

TAX ON SHARES

Beneficiary	Share	Tax
Spouse B		
Grain & livestock	$ 40,000.00	
Stocks & bonds, bank accounts	35,000.00	
Life estate in farm (.24481 × 504,000)	123,384.24	
Total Share	$198,384.24	$3,028.05
Child C		
½ remainder		
$\frac{504{,}000 \times .75519}{2}$	$190,307.88	
Less: ½ debts & charges	68,050.00	
Net Share	$122,257.88	$2,687.89
Child D		
Same as Child C	122,257.88	2,687.89
Total shares and add'l inheritance tax	$442,900.00	$ 8,403.83
Credit for state death taxes paid (since this is greater, it is the add'l tax due before credit for tax previously paid)		$12,800.00
Less tax previously paid ($1,081.83 total for A, B & C)		1,081.83
Additional inheritance/estate tax due		$11,718.17
Interest from 4-1-83 to 4-15-86, the due date		3,563.61
Total additional tax and interest		$15,281.78

NOTE: The life estate-remainder factor is based on the age of the life tenant in 1982, not in 1985 when the early disposition of the real estate was made.

d. Computation of the tax—full disposition or full cessation. If there is an early disposition or a cessation of the qualified use of all of the real estate specially valued, the inheritance tax on the shares of all persons who succeed to the real estate from the decedent are recomputed based on the fair market value of the specially valued real estate. See 86.8(6)*"c"* on which market value to use. The total revalued share of each person who had an interest in the disqualified real property is the value of that person's share of the property not specially valued plus the revalued share of the special use property. The tax is then recomputed based on the applicable exemption, if any, allowable under Iowa Code section 450.9 and the rates of tax specified in Iowa Code section 450.10 in effect at the time of the decedent's death. A credit is allowed against the amount of the recomputed tax, without interest, for the tax paid which was based on the special use value.

EXAMPLES: Disposition of all of the qualified real property.

It is assumed in these examples that the real estate has qualified for special use valuation and that prior to the date of disposition, the real estate remained qualified.

EXAMPLE 1. Farmer A, a widower, died July 1, 1982, a resident of Iowa, and by will left all of his property to his three children in equal shares. Child B farms the family farm. Child C lives in Des Moines, Iowa, and Child D lives in Phoenix, Arizona. At the time of death, Farmer A's estate consisted of:

Asset	Fair Market Value	Special Use Value
160-acre Iowa farm	$ 480,000 ($3,000 per acre)	$ 160,000 ($1,000 per acre)
Grain and livestock	60,000	60,000
Stocks, bonds and bank accounts	50,000	50,000
Gross Estate	$ 590,000	$ 270,000
Less: Deductions without federal estate tax	25,000	25,000
Net estate before federal estate tax	$ 565,000	$ 245,000

COMPUTATION OF THE INHERITANCE TAX
UNDER SPECIAL USE VALUATION

Net estate before federal estate tax	$245,000
Less: federal estate tax	4,120
Net Estate	$240,880

TAX ON SHARES

Beneficiary	Share		Tax
To each child	$80,293.33		$786.73
Total Tax Paid	$786.73 × 3	=	$2,360.19

NOTE: The federal credit for state death taxes paid is $2,280, which is less than the inheritance tax. Therefore, the tax due is $2,360.19.

On October 15, 1985, Child B, the qualified heir, retires from farming and all three children sell the farm to a nonrelated party for $3,200 per acre, or $512,000. Under 86.8(6)*"c,"* the $3,000 per acre valuation at death governs the computation of the additional inheritance tax.

COMPUTATION OF THE ADDITIONAL INHERITANCE TAX DUE TO THE EARLY
DISPOSITION OF THE QUALIFIED USE PROPERTY

Net estate before federal estate tax	$565,000
Less: Revised federal estate tax ($12,600 was deducted for credit for state death taxes paid)	104,450
Net Estate	$460,550

Tax on Shares	Share	Tax
To each child $153,516.66	$4,571.16	
Less tax previously paid	786.73	
Additional tax due		$3,784.43
Interest at 10% from 4-1-83 to due date 4-15-86		1,150.88
Total Due Each Child		$4,935.31

Total additional tax and interest for all three shares $4,935.31 × 3 = $14,805.93.

NOTE: In this example, the total additional tax for the three children before a credit for tax previously paid, is $4,571.16 × 3 or $13,713.48. The credit for state death taxes paid on the revalued federal estate is $12,600.00. Therefore, the larger amount is the additional tax, before the credit for tax previously paid is deducted. The additional inheritance or Iowa estate tax bears interest at 10 percent beginning nine months after the decedent's death until the due date, which is six months after the disposition of the specially valued real estate. Interest accrues on delinquent tax at the same rate. Since interest only accrues on unpaid tax, the amount of the interest in this example would have been less if the tax had been paid prior to its due date, April 15, 1986.

e. Computation of the tax—partial disposition or cessation of the qualified use.

(1) First partial disposition or cessation of the qualified use. Compute the maximum amount of the additional tax that would be due from each person who has an interest in the portion of the real estate no longer eligible to be specially valued, as if there were an early disposition or cessation of the qualified use of all that person's specially valued real estate. The additional tax on a partial disposition or cessation of the qualified use is computed by multiplying the maximum amount of the additional tax by a fraction of which the fair market value of the portion no longer eligible is the numerator and the fair market value of all of that person's specially valued real estate is the denominator. The resulting amount is the tax due on the first partial disposition or cessation of the qualified use.

EXAMPLE 1. First partial additional tax. Assume the fair market value of three parcels of real estate owned by a single qualified heir is $100,000 and the special use value of the three parcels is $75,000. The qualified heir is in the 10 percent tax bracket. FMV in this example means fair market value.

Parcel 1, fair market value	$25,000
Parcel 2, fair market value	50,000
Parcel 3, fair market value	25,000

Computation of Maximum Amount of Additional Tax

Tax based on fair market value ($100,000 × 10%)	$10,000
Tax based on special use value ($75,000 × 10%)	7,500
Maximum amount of additional tax	$ 2,500

Computation on the First Partial Additional Tax
Parcel 1, sale to an unrelated party

FMV of Parcel 1	$ 25,000	×	$2,500 (Maximum	=	$625 (First
FMV of all special use property	$100,000		add'l tax)		add'l tax)

(2) Second or any succeeding disposition or cessation of the qualified use. Compute the maximum amount of the additional tax as outlined in the first partial disposition or cessation of the qualified use. Increase the numerator of the fraction used to determine the first additional tax by the fair market value of the second partial disposition or cessation of the qualified use. The denominator remains the same. The computed tax is then credited with the tax paid on the first partial disposition or cessation of the qualified use. Succeeding partial dispositions or cessations of the qualified use are handled in the same manner by increasing the numerator of the fraction and a corresponding increase in the credit for the prior additional tax paid.

Computation of the second and succeeding partial dispositions or cessations of the qualified use can be illustrated by the following examples:

EXAMPLE 2. Second partial additional tax. Same facts in Example 1. In this example, Parcel 2 is sold to an unrelated party.

Computation of the Second Partial Additional Tax

FMV of Parcels 1 & 2	$ 75,000 / $100,000	×	$2,500 (Maximum add'l tax)	= $1,875
FMV of all special use property				
Less tax paid on Parcel 1				625
Second Add'l Tax				$1,250

EXAMPLE 3. Third partial additional tax. Same facts in Example 1. In this example, Parcel 3 is sold to an unrelated party.

Computation of the Third Partial Additional Tax

FMV of Parcels 1, 2, & 3	$100,000 / $100,000	×	$2,500 (Maximum add'l tax)	= $2,500
FMV of all specially valued real estate				
Less tax paid on Parcels 1 & 2				1,875
Third Additional Tax				$ 625

f. No additional tax on shares not revalued. The shares of persons who received no interest in the real estate which is no longer eligible to be specially valued are not subject to an additional tax. Therefore, on the amended final inheritance tax return only the shares of the persons receiving interest in the real estate need to be revalued when computing the additional tax under this subrule.

EXAMPLE. Decedent A, a widower and resident of Iowa, died testate July 1, 1982, survived by son B and daughter C. His estate consisted of two Iowa farms and certain personal property. Under A's will, each child shares equally in the personal property. Son B received one farm and daughter C the other one. Son B, a qualified heir, elected to specially value his farm and daughter C did not. The inheritance tax was paid on this basis. Five years after A's death, son B quits farming and sells his inherited farm to an unrelated party, thus incurring an additional inheritance tax. Only son B owes an additional tax. Daughter C's share in the estate is not revalued.

86.8(8) *Return for additional inheritance tax.* The return reporting the additional inheritance or Iowa estate tax imposed due to the early disposition or cessation of the qualified use shall conform as nearly as possible to the federal additional estate tax return, Form 706A, as can be done within the framework of an inheritance tax on shares instead of an estate tax. The return must be executed by the qualified heir and filed with Fiduciary and Inheritance Tax Processing, P.O. Box 10467, Des Moines, Iowa 50306.

86.8(9) *Due date for paying the additional inheritance tax.* The additional inheritance or Iowa estate tax imposed by Iowa Code section 450B.3 or 451.2 and the return for the additional tax is due six months after the early disposition or cessation of the qualified use of the real estate specially valued.

86.8(10) *No extension of time to file or pay.* Iowa Code chapter 450B makes no provision for an extension of time to file the return for the additional tax and pay the additional inheritance tax or Iowa estate tax due. Therefore, if the return for the additional tax is not filed or the additional inheritance or Iowa estate tax is not paid within six months after the early disposition or cessation of the qualified use, the return or the tax is delinquent and subject to penalty under subrule 86.8(13).

86.8(11) *Interest on additional tax*. The additional inheritance or Iowa estate tax imposed under Iowa Code section 450B.3 or 451.2, accrues interest at the rate of 10 percent per annum until paid commencing nine months after the decedent's death. The variable prime interest rate made applicable to inheritance tax by 1981 Iowa Acts, chapter 131, sections 15 and 16, on real estate not specially valued, does not apply to interest due on the additional tax imposed by Iowa Code section 450B.3 or 451.2. In addition, the federal rule that interest only accrues on the additional federal estate tax when an election is made under 26 U.S.C. Section 1016(c) to increase the basis for gain or loss on the real estate no longer eligible to be specially valued, has no application to Iowa special use valuation. In this respect the Iowa law does not conform to the federal statute.

86.8(12) *Receipt for additional tax.* The receipt for the additional tax imposed by Iowa Code section 450B.3 or 451.2, is separate and distinct from the receipt for inheritance tax required by Iowa Code section 450.64. The receipt must identify the property which was the subject of the early disposition or cessation of the qualified use, the owners of the property, the qualified heir, the amount paid and whether the additional tax paid is for a partial or full disposition or cessation of the qualified use.

86.8(13) *Penalty for failure to file or failure to pay.* Department subrules 86.2(15) and 86.2(16) pertaining to the penalty for failure to timely file the return or to pay the inheritance tax imposed by Iowa Code chapter 450, also apply where there is a failure to timely file the return reporting the additional inheritance or Iowa estate tax or to pay the additional tax due imposed by Iowa Code section 450B.3 or 451.2.

86.8(14) *Duties and liabilities.*

a. Duty to report an early disposition or cessation of the qualified use. The agent designated in the agreement required by 86.8(5)*"e"* has the duty to notify the department of any early disposition or cessation of the qualified use of the property on or before the due date of the additional inheritance tax. An executed copy of the notice required by federal regulation Section 20.2032A(c)(4) will satisfy this subrule.

b. Liability for payment of the tax. The qualified heir or the heir's successor is personally liable for all the additional inheritance or Iowa estate tax imposed under Iowa Code section 450B.3 or 451.2. It is the qualified heir's duty to collect the additional Iowa inheritance or Iowa estate tax from each person whose share was revalued. In respect to the additional tax, the duty of the qualified heir is the same as the duty of the fiduciary of an estate or trust under Iowa Code section 450.5, for the regular inheritance or Iowa estate tax. See subrule 86.2(1) regarding the responsibility of the fiduciary of an estate or trust. While the qualified heir is primarily liable for the payment of all of the additional tax, each person who has an interest in the real estate no longer eligible to be specially valued is also liable under the agreement provided for in 86.8(5)*"e"* for additional tax on that person's revalued share. Therefore, if the qualified heir fails to pay the additional Iowa estate tax or the additional tax imposed on any revalued share, the department may proceed to collect the delinquent tax from the person who received the share. The liability for the additional tax due from each person who had an interest in the revalued real estate is the same as the liability for the inheritance tax on property not specially valued. See *Eddy v. Short*, 190 Iowa 1376, 1380, 1832, 179 N.W. 818 (1920); *In re Estate of Stone*, 132 Iowa 136, 109 N.W. 455 (1906).

c. Books and records. It is the duty of the qualified heir to keep books and records necessary to substantiate the continued eligibility of the real estate for special use valuation. Upon request, the agent designated in the agreement shall furnish the department sufficient information relating to the use, ownership and status of the real estate to enable the department to determine whether there has been an early disposition or cessation of the qualified use.

86.8(15) *Special lien for additional inheritance tax.*

a. In general. The special lien created by Iowa Code section 450B.6 is separate and distinct from the lien provided for in Iowa Code section 450.7, for the inheritance tax imposed at the time of the decedent's death. The special lien is to secure any additional inheritance or Iowa estate tax that may be due within the ten-year period after the decedent's death, should there be an early disposition or cessation of the qualified use. The inheritance tax lien provided for in Iowa Code section 450.7 is only to secure the tax imposed at the time of the decedent's death on the transfer of property including property that is specially valued. If an additional tax is imposed for the early disposition or cessation of the qualified use, it is secured by the lien created by Iowa Code section 450B.6.

b. Form of the notice of the special lien. The notice of the special lien for additional inheritance or Iowa estate tax created by Iowa Code section 450B.6 must conform as nearly as possible to the special use valuation lien provided for in 26 U.S.C. Section 6324B.

c. Notice of lien. Unlike the lien provided for in Iowa Code section 450.7, notice of the special lien for additional inheritance or Iowa estate tax must be recorded before it has priority over subsequent mortgagees, purchasers or judgment creditors. The special lien is perfected by recording the notice of the special lien in the recorder's office in the county where the estate is being probated (even though the real estate may be located in a different county). Failure to perfect the special lien by recording as provided for in Iowa Code section 450B.6 divests the qualified real property from the lien in the event of a sale to a bona fide purchaser for value.

d. Duration of the special lien. The special lien continues:

(1) Until the additional inheritance or Iowa estate tax is paid, or ten years after the date the additional tax is due, whichever first occurs, if there is an early disposition or cessation of the qualified use, or

(2) For ten years after the decedent's death on all other property which has been specially valued.

e. Release of the lien. The special lien for additional inheritance tax:

(1) May be released at any time in whole or in part upon adequate security being given to secure the additional tax that may be due, if any.

(2) Is released by payment of the additional inheritance or Iowa estate tax imposed by Iowa Code section 450B.3 or 451.2, on the property which was the subject of an early disposition or cessation of the qualified use.

(3) Is released when it becomes unenforceable by reason of lapse of time.

f. Application to release the lien. Ten years after the decedent's death, unless there is an additional tax remaining unpaid, the qualified heir may submit to the department an application in writing for release of the lien on the real estate specially valued. The application must contain information necessary to enable the department to determine whether or not the special use valuation lien should be released. If, after audit of the application, it is determined the real estate remained eligible for special valuation, the department will release the lien and file a certificate of nonliability in the probate proceedings of the decedent's estate.

86.8(16) *Valuation of the decedent's interest in corporations, partnerships and trusts—special rules.* If the decedent's interest in a corporation, partnership or a trust has been valued at its special use valuation under 26 U.S.C. Section 2032A for federal estate tax purposes, it is also eligible to be valued at its special use value for inheritance tax purposes, subject to the limitation imposed by statute and these rules. See Internal Revenue Service letter ruling 8108179 (1980) for guidelines in valuing the decedent's interest. Other factors indicative of value, such as the value of other assets, net dividend-paying capacity, book value, profit and loss statements and net worth must also be taken into account in arriving at the value of the decedent's interest for inheritance tax purposes. See Revenue ruling 59-60, 1959-1 C.B. 243 for the factors to be considered in valuing closely held corporate stock. In the event the decedent's interest in a corporation, partnership or trust is no longer eligible to be specially valued, the additional inheritance tax will be imposed on the fair market value of the decedent's interest in the same manner and subject to the same limitations as other property specially valued.

86.8(17) *Audits, assessments and refunds*. Subrules 86.3(1) to 86.3(3) providing for the audit, assessment and refund of the inheritance tax imposed by Iowa Code sections 450.2 and 450.3, shall also be the rules for the audit, assessment and refund of the additional inheritance or Iowa estate tax imposed by Iowa Code section 450B.3 or 451.2.

86.8(18) *Appeals*. Rule 86.4(450) providing for an appeal to the director and a subsequent appeal to district court under the Iowa administrative procedure Act for disputes involving the inheritance tax imposed by Iowa Code chapter 450 shall also be the rule for appeal for disputes concerning special use valuation and the additional inheritance or Iowa estate tax imposed by Iowa Code chapters 450B and 451.

This rule is intended to implement Iowa Code sections 450B.1 to 450B.7 and 451.2.

701—86.9(450) Market value in the ordinary course of trade. Fair market value of real or personal property is established by agreement or the appraisal and appeal procedures set forth in Iowa Code section 450.37 and 701—paragraph 86.8(4)*"b."* If the value is established by agreement, the agreement may be to accept the values of such property as submitted on the Iowa inheritance tax return, to accept a negotiated value or to accept the values as finally determined for federal estate tax purposes. Values submitted on an inheritance tax return constitute an offer regarding the value of the property by the estate. An inheritance tax clearance that is issued based upon property values submitted on an inheritance tax return constitutes an acceptance of those values on that return. An agreement to accept negotiated values or accept values as finally determined for federal estate tax purposes must be an agreement between the department of revenue and finance, the personal representative, and the persons who have an interest in the property. If an agreement cannot be reached regarding the valuation of real property, then the department may request, within 30 days after the return is filed, an appraisal pursuant to Iowa Code sections 450.37 and 450.27 and 701—subrule 86.9(4). If an appraisal is not requested within the required period, then the value listed on the return is the agreed value of the real property. If an agreement cannot be reached regarding the valuation of personal property, the personal representative or any person interested in the personal property may appeal for a revision of the department's value as set forth in Iowa Code section 450.37 and 701—paragraph 86.9(4)*"b."* Any inheritance tax clearance granted by the department may be subject to revision based on federal audit adjustments. Absent an agreement to the contrary, the six-month extension of the statute of limitations for assessing Iowa inheritance tax based on federal audit adjustments is limited to federal audit adjustments that directly affect Iowa inheritance tax and involve Iowa inheritance tax law that incorporates Internal Revenue Code provisions—see Iowa Code section 450.94(5) and *Kelly-Springfield Tire Co. v. Iowa State Board of Tax Review,* 414 N.W.2d 113 (Iowa 1987).

86.9(1) *In general.* With the exception of real estate which has been specially valued under Iowa Code chapter 450B, property included in the gross estate for inheritance tax purposes must be valued under the provisions of Iowa Code section 450.37 at its market value in the ordinary course of trade. See rule 701—86.10(450) for the rule governing the market value in the ordinary course of trade if the alternate valuation date is elected. "Market value in the ordinary course of trade" and "fair market value" are synonymous terms. *In re Estate of McGhee,* 105 Iowa 9, 74 N.W. 695 (1898). Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includable in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item whenever appropriate. See federal regulation Section 20.2031(1)(b) and Iowa Code section 441.21(1)*"b"* for similar definitions of fair market value.

86.9(2) *Values not to be used.* Other kinds of value assigned to property such as, but not limited to, assessed value of real estate for property tax purposes, cost price, true value, or book value are only relevant in computing the value of the property for inheritance tax purposes, to the extent they may be properly used in the determination of fair market value or special use value. *In re Estate of McGhee,* 105 Iowa 9, 74 N.W.695 (1898). Fair market value cannot be determined alone by agreement between the persons succeeding to the decedent's property. Also, fair market value cannot be determined alone by setting out in the decedent's will the price for which property can be sold. *In re Estate of Fred W. Rekers,* Probate No. 28654, Black Hawk County District Court, July 26, 1972.

86.9(3) *Date of valuation.* Unless the alternate valuation date is elected under Iowa Code section 450.37, or the tax has been deferred according to Iowa Code sections 450.44 to 450.49, all property includable in the gross estate must be valued at the time of the decedent's death for the purpose of computing the tax imposed by Iowa Code section 450.2. Subject to the two exceptions listed, any appreciation or depreciation of the value of an asset after the decedent's death is not to be taken into consideration. *Insel v. Wright County,* 208 Iowa 295, 225 N.W.378 (1929).

86.9(4) *Market value — how determined.*

a. By agreement between the department, the estate and its beneficiaries. Iowa Code section 450.37 provides that the market value in the ordinary course of trade is to be determined by agreement between the estate and its beneficiaries and the department. The term "agreement" when used with reference to the value of an asset, whether it is real or personal property, has the same meaning as the term is used in the law of contracts. The agreement between the department, the estate and its beneficiaries may be contained in a single written instrument, or it may be made by an offer submitted by the estate and its beneficiaries and its acceptance by the department. The agreement establishing values for computing the tax may specify that the values as finally determined for federal estate tax purposes on all or a portion of the assets will be the values used in computing the tax.

(1) Offer by the estate and the beneficiaries. It is the duty of the taxpayer to list on the inheritance tax return the values of the assets in the gross estate which the estate and those beneficially entitled to the decedent's property are willing to offer as the values for computing the taxable shares in the estate. The value of the assets listed on the return will constitute an offer for the department to accept or reject. Counteroffers may be made in the event an offer is rejected. This rule applies equally to real and personal property.

(2) Acceptance of values by the department. The values offered on the inheritance tax return by the estate and its beneficiaries are accepted by the department when:

1. The department has accepted the offered values in writing, or

2. A clearance certifying full payment of the tax due or a clearance certifying no tax due is issued by the department, or

3. The department does not request an appraisal within 30 days after the return has been filed in the case of the value of real estate. However, see 86.9(4)*"a"*(3) for the rule governing values listed as "unknown" or "undetermined." See Iowa Code sections 622.105 and 622.106 for the law determining the filing date of a tax return that is mailed.

(3) Values listed on the return as "undetermined" or "unknown." If at the time the inheritance tax return is filed the information necessary to determine the value of an asset cannot be presently ascertained, the taxpayer may list the value of that asset as "unknown" or "undetermined." The return must contain a statement signed by the taxpayer on behalf of the estate and the beneficiaries with an interest in the property granting the department an extension of time for requesting an appraisal until 30 days after an amended return is filed listing a value for the real estate. Failure to grant an extension of time will subject the real estate to an immediate request for an appraisal. The amended return shall be accompanied with sufficient facts and other information necessary to substantiate the value offered. An agreement concerning the value of an asset presupposes that both the department, the beneficiaries and the estate have knowledge of the relevant facts necessary to determine value. There can be no meaningful agreement or appraisal until the relevant facts relating to value are known. See *Bair v. Randall,* 258 N.W.2d 333 (Iowa 1977) regarding the criteria that may be used to determine the value of an asset which was unknown at the time of the decedent's death.

b. Values established — no agreement.

(1) *Real estate.* If the department, the estate and the persons succeeding to the decedent's property have not reached an agreement as to the value of real estate under 86.9(4)*"a,"* the market value for inheritance tax purposes will be established by the appraisal proceedings specified in Iowa Code sections 450.27 to 450.36. Use of the inheritance tax appraisers to determine value for other purposes such as, but not limited to, determining the share of the surviving spouse in the estate or for determining the fair market value of real estate for the purposes of sale, are not controlling in determining values for inheritance tax purposes. *In re Estate of Giffen,* 166 N.W. 2d 800 (Iowa 1969); *In re Estate of Lorimor,* 216 N.W.2d 349 (Iowa 1974).

(2) *Personal property.* Effective for estates of decedents dying on or after July 1, 1983. If an agreement is not reached on the value of personal property under 86.9(4)*"a,"* the estate or any person beneficially receiving the personal property may appeal to the director under Iowa Code section 450.94, subsection 3, for a resolution of the valuation dispute, with the right of judicial review of the director's decision under Iowa Code chapter 17A.

c. Amending returns to change values.

(1) *Amendment permitted or required.* Unless value has been established by the appraisal or administrative proceedings, the inheritance tax return may be amended by the estate to change the value of an asset listed on the return as long as the amendment is filed before an agreement is made between the estate and the department as to the asset's value. The return must be amended to list the value of an asset omitted from the original return or to assign a value for an item listed on the original return as "unknown" or "undetermined."

If the facts and circumstances surrounding the value agreement would justify a reformation or rescission of the agreement under the law of contracts, the return may be amended by the estate, and must be amended at the department's request, to change the value of the item to its correct fair market value or its special use value as the case may be.

(2) *Amendment not permitted.* A return cannot be amended:

1. To change the agreed value of an asset, if the facts and circumstances surrounding the agreement would not justify a reformation or rescission of the agreement,

2. To change a real estate value that has been established by the appraisal proceedings under Iowa Code sections 450.31 to 450.33, *Insel v. Wright County*, 208 Iowa 295, 225 N.W.378 (1929), or

3. To change the value of an item of personal property that has been established by the department's administrative procedure under 701—Chapter 7 or, if an appeal is taken from the director's decision, by judicial review under Iowa Code chapter 17A. Provided, in no event may the return be amended to lower the value of an asset that would result in a refund of tax more than five years after the tax became due or one year after the tax was paid, whichever time is the later. Iowa Code section 450.94, *Welp v. Department Of Revenue*, 333 N.W.2d 481 (Iowa 1983).

86.9(5) *Fair market value of personal property.*

a. In general. The fair market value of an item of property, both real and personal, that is included in the gross estate for inheritance tax purposes is expressed in the property's monetary equivalent. The process used to determine fair market value presupposes the voluntary exchange of the item in a market for its equivalent in money. *Hetland v. Bilstad*, 140 Iowa 411, 415, 118 N.W. 422 (1908). The fact the item of property is not actually sold or exchanged or even offered for sale is not relevant. It is sufficient for establishing the item's value to arrive at the specific dollar amount that a seller would voluntarily accept in exchange for the property and the amount that a buyer would be willing to pay. *Juhl v. Greene County Board of Review*, 188 N.W.2d 351 (Iowa 1971). It is assumed when determining this specific dollar amount, which is the item's fair market value, that the seller is desirous of obtaining the highest possible price for the property and that the buyer does not wish to pay more than is absolutely necessary to acquire the property.

The item of property must be valued in a market where it is customarily traded to the public. See Federal Regulation 20.2031-1(b). Therefore, if an item of property is valued in a market which is not open to the general public, the party asserting the value in the restricted market has the burden to prove by a preponderance of the evidence that the value in the restricted market is the item's fair market value.

The distinction between a public and a restricted market can be illustrated by the following:

EXAMPLES:

1. Under the provisions of the decedent's will, the personal representative of the estate is given the power to sell the decedent's property at either a public or private sale. Pursuant to this power, the personal representative sold the decedent's household goods at public auction held on a specific day and time which was widely advertised both in the newspaper in the locality where the decedent lived and also by sale bills posted in numerous public places in the decedent's community. The household goods sold at auction for $2,500. The fair market value of the household goods on the day of sale is $2,500. The public auction is a market where such items are commonly sold and the public had knowledge of the impending sale. The public was also invited to bid and the items to be sold were available for inspection.

2. Pursuant to an agreement between the beneficiaries of the estate, the personal representative sold the decedent's household goods and personal effects at an auction where only members of the decedent's family were permitted to bid. The items sold for $2,500, which may or may not be the fair market value of the property. Family pride, sentiment and other personal considerations may have entered into the selling price. In this type of sale, the burden is on the personal representative to prove that the selling price is the fair market value of the items sold.

b. Values established by recognized public markets.

(1) *Stocks, bonds, and notes.* Items of personal property such as, but not limited to, corporate stock, bonds, mutual funds, notes and commodities which are traded on one or more of the nation's stock or commodity exchanges shall be valued under the provisions of Federal Estate Tax Regulation 20.2031-2, which regulation is incorporated in and made a part of this subrule by reference.

(2) *Local elevator and sale barn prices.* The fair market value of grain and livestock may be determined either by the quoted price from the grain elevator or sale barn in the community where the grain or livestock is located or by the price quoted from the nearest commodity exchange, less the customary delivery discount.

(3) *Public auctions by the court.* The fair market value of an item may be established in a public market other than a market which has a permanent location and which holds sales at periodic stated intervals. It is common for estates or the probate court to hold a public auction to sell estate property and if the sale meets certain criteria the selling price received in this type of public auction will establish the fair market value of the property. Factors in an estate or court sale which tend to establish the selling price as one at fair market value include but are not limited to: the time and place of the sale were well advertised; the public was invited and encouraged to bid; members of the decedent's family or business associates were not given special consideration as to price or terms of sale; and the terms of sale were comparable to those offered at sales in a regularly established public market.

(4) *Sales in a regularly established market.* Sales made in a regularly established market pursuant to Iowa Code section 633.387 would qualify as a sale at fair market value for inheritance tax purposes.

c. Private sales that may establish fair market value. Private sales of estate assets may establish the fair market value of the item depending on the facts and circumstances surrounding each sale. Factors which tend to establish a private sale as one at fair market value include but are not limited to:

(1) Sales made by a recognized broker who receives a commission from the seller based on the selling price and who has exercised diligence in obtaining a buyer.

(2) Sales made by the personal representative to nonfamily members after a good faith effort was made to solicit bids from persons who are known to be interested in buying that particular kind of property.

(3) Sales made by the attorney or the personal representative after the item of property was advertised for sale in a newspaper of general circulation or in trade publications and a good faith effort was made to obtain the best possible price.

(4) Sales made by the personal representative when the sale price is the price quoted on one of the nation's stock or commodity exchanges.

(5) Private sales made by the personal representative to members of the decedent's family or business associates are suspect due to personal, family or business reasons, but nevertheless may constitute a sale at fair market value, depending on the facts and circumstances surrounding each sale. The personal representative has the burden to establish that this kind of private sale is a sale at fair market value. Factors which have a bearing on whether this type of private sale is one at fair market value include, but are not limited to: Did the decedent's will give a sale or price preference to a member of the decedent's family or business associate? Were the terms of sale more advantageous than terms that would be given to the general public? Was a good faith effort made to solicit bids from other persons known to be interested in buying that particular kind of property? and Was the sale made as part of a family settlement of a will contest or dispute on a claim against the estate?

d. Fair market value — no regularly established market.

(1) *In general*. Certain items of personal property, such as but not limited to, closely held corporate stock, real estate contracts of sale, private promissory notes, accounts receivable, partnership interests and choses in action are not customarily bought and sold in a public market. Occasional sales of these items of personal property at infrequent intervals do not establish a market for this kind of personal property, but the lack of a regular market does not indicate that the item is of no value. When there is not a regularly established market to use as a reference point for value, it is necessary to create a hypothetical market to determine fair market value. The factors used to create a hypothetical market vary with the kind of property being valued and depend on the facts and circumstances in each individual case.

This subrule is illustrated by the following example:

EXAMPLE: Decedent A died a resident of Iowa on July 1, 1984. The gross estate consisted of 1500 shares of corporate stock in Black Acre, Inc., a farm corporation with 5000 shares outstanding, the balance of the corporate shares was owned by members of A's family. Also included in the gross estate was a 160-acre farm worth $2000 per acre, or $320,000; a real estate contract of sale bearing 6 percent interest with the decedent's tenant as buyer with a balance due of $105,000; and $75,000 face amount of U.S. Treasury Bonds. In this example, there is a regularly established market for the 160-acre farm and the treasury bonds and they are to be valued under 86.9(4) and 86.9(5)*"b"*(1), respectively. There is no regularly established market for the corporate stock or the real estate contract of sale and they must be valued according to the provisions of this subrule.

(2) *Fair market value of closely held corporate stock.* A closely held corporation is a corporation whose shares are owned by a relatively limited number of stockholders. Often the entire stock issue is held by members of one family or by a small group of key corporate officers. Because of the limited number of stockholders and due to a family or business relationship little, if any, trading in the shares takes place. There is, therefore, no established market for the stock. Sales that do occur are usually at irregular intervals and seldom reflect all of the elements of a representative transaction as is contemplated by the term fair market value. The term "fair market value" has the same meaning for federal estate tax purposes as it does for Iowa inheritance tax purposes. As a result, the federal revenue rulings establishing the criteria for valuing closely held corporate stock are equally applicable to inheritance tax values. Therefore, corporate stock which meets the standards for being closely held must be valued for inheritance tax purposes under the provisions of Federal Revenue Ruling 59-60, 1959-1 C.B. 237 as modified by Revenue Ruling 65-193, 1965-2 C.B. 370 and amplified by Revenue Ruling 77-287, 1977-2 C.B. 319, Revenue Ruling 80-213, 1980-2 C.B. 101, and Revenue Ruling 83-120, 1983-2 C.B. 170, which Federal Revenue rulings are incorporated in and made a part of this subrule by reference.

(3) *Fair market value of real estate contracts, notes and mortgages.* The fair market value of promissory notes, secured or unsecured, contracts for the sale of real estate and other obligations to pay money which are included in the gross estate is presumed to be the amount of the unpaid principal plus the amount of interest, if any, accrued to the day of the decedent's death. If the asset is not reported on the return at face value plus accrued interest, the burden is on the party claiming a greater or lesser value to establish that face value plus accrued interest is not the asset's fair market value.

Factors which have a bearing on whether the fair market value of an asset is greater or less than face value include but are not limited to the rate of interest charged on the obligation; the length of time remaining on the obligation; the credit standing and payment history of the debtor; the value and nature of the property, if any, securing the obligation; the relationship of the debtor to the decedent; and whether the obligation is to be offset against the debtor's share of the estate. See *Welp v. Department of Revenue,* 333 N.W.2d 481 (Iowa 1983). This subrule can be illustrated by the following:

EXAMPLES:

1. The decedent at the time of death owned a seller's interest in an installment sale contract for the sale of a 160-acre farm. The contract contained a forfeiture provision in the event the buyer failed to make the payments and further provided that the purchase price was to be paid in 20 equal annual principal payments plus interest at 7 percent per year on the unpaid principal balance. At the time of the decedent's death, the contract of sale had ten years yet to run and the current federal land bank interest rate for farm land loans was 12 percent. Assuming in this example that other valuation factors are not relevant, the fair market value of the contract is the face amount of the contract, plus interest, discounted to reflect a 12 percent interest return on the outstanding principal balance. A prudent investor would not invest at a lower rate of interest when a comparable investment with equal security would earn 12 percent interest.

2. A tenant of the decedent owed the decedent $5,000, which was evidenced by a promissory note, payable on demand, drawing 6 percent interest, and which was executed in 1982, a year prior to the decedent's death. Assuming no other valuation factors are relevant, the fair market value of the $5,000 promissory note is its face value, plus accrued interest. The less than market interest rate on the note does not affect its fair market value because the note is due on demand and as a consequence, there is no loss of a higher rate of interest which would be the case if the note specified a future payment date.

3. Decedent A died intestate July 1, 1983, survived by two sons, B and C. The estate consisted, after debts and charges, of $300,000 in cash and U.S. Government Bonds and a non-interest-bearing promissory note for $10,000 executed by son B in 1950 for money borrowed for his college education. No payments were ever made on the note. The note is outlawed by the statute of limitations and would be worthless if anyone other than son B or C had executed the note. However, since son B inherits one-half of A's estate, and is required under the law of setoff and retainer to pay the note before he can participate in the estate, the fair market value of the note in this particular fact situation is $10,000 because it is collectible in full. Each son's share of the estate is $155,000. Son C receives $155,000 in cash and son B receives $145,000 in cash plus his canceled note for $10,000. In this example, the statutory right of setoff and retainer supersedes other factors which are relevant in determining the fair market value of the asset. See Iowa Code section 633.471; *In re Estate of Farris,* 234 Iowa 960, 14 N.W.2d 889 (1944); *Indiana Department of Revenue v. Estate of Cohen,* Ind. App. 436 N.E.2d 832 (1982), *Gearhart's Ex'r and Ex'x v. Howard,* 302 Ky. 709, 196 S.W.2d 113 (1946).

(4) *Fair market value of a sole proprietorship or partnership interest.* The fair market value of the decedent's interest in a business, whether a partnership or a proprietorship, is the net amount a willing buyer would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts. Relevant factors in determining net value include but are not limited to: a fair appraisal as of the applicable valuation date of all of the assets of the business, tangible and intangible, including goodwill; the demonstrated earning capacity of the business; and the other factors in 701—subparagraph 89.9(5)*"d"*(2), to the extent they are applicable, that must be considered in valuing closely held corporate stock.

(5) *Fair market value of choses in action.* The fair market value of the decedent's interest in a right to sue for a debt or a sum of money often cannot be determined with certainty at the time of the decedent's death. The value of this right is dependent on many factors which include but are not limited to: the strength and credibility of the decedent's evidence; the statutory and case law supporting the decedent's claim or position; the ability of the opposing party to pay a judgment; the extent, if applicable, of the decedent's contributory negligence; and the other normal hazards of litigation. However, this lack of certainty does not mean the right to sue has no value at the time of the decedent's death. Evidence of what was actually received for this right by the decedent's estate or its beneficiary is evidence of the fair market value of the right at death.

This subrule can be illustrated by the following:

EXAMPLE:

The decedent died in a fire of uncertain origin that destroyed his dwelling. Due to the circumstances surrounding the fire, the estate's right of recovery from the fire insurance carrier was speculative and therefore, the value of this right at death was unknown. After the estate was closed, the beneficiary of the estate settled the fire insurance claim for $15,000. The amount received in settlement of the claim can be considered as evidence of the fair market value of the right of action at death. *Bair v. Randall*, 258 N.W.2d 333 (Iowa 1977).

This rule is intended to implement Iowa Code sections 450.27 to 450.37 and 450.44 to 450.49.

701—86.10(450) Alternate valuation date.

86.10(1) *When available*. The alternate valuation date allowed by 26 U.S.C. Section 2032 is available for estates of decedents dying on or after July 1, 1983, on the same terms and conditions which govern the alternate valuation date for federal estate tax purposes. Effective for estates of decedents dying after July 18, 1984, the alternate valuation date cannot be elected unless the value of the gross estate for federal estate tax purposes is reduced and the amount of federal estate tax owing, after all credits have been deducted, has also been reduced. See 26 U.S.C. Section 2032(c) enacted by Public Law 98-369 Section 1023(a). In general, the alternate valuation date is the date six months after the decedent's death. If property is sold within the six-month period, the date of sale is the alternate date for valuing the property sold. See Federal Regulation Section 20.2032-1, as amended December 28, 1972, for the rules governing the valuation of property in the gross estate at its alternate valuation date for federal estate tax purposes. If the election is made, all of the property included in the gross estate and not just a portion of the property, must be valued at the alternate valuation date. Provided, the estate may elect both the alternate valuation date and the special use value under Iowa Code chapter 450B, if the estate is otherwise qualified. See Federal Revenue Ruling 83-31(1983). It is a precondition for valuing the property at its alternate value for Iowa inheritance tax purposes that the property has been valued at the alternate value for federal estate tax purposes. However, even if the property in the gross estate is valued at the alternate valuation date for federal estate tax purposes, the estate has the option either to elect or not to elect the alternate valuation date for Iowa inheritance tax purposes. If the alternate valuation date is elected, the value established for federal estate tax purposes shall also be the alternate value for inheritance tax purposes. The election is an affirmative act and for estates of decedents dying prior to July 19, 1984, it must be made on a timely filed inheritance tax return, taking into consideration any extensions of time granted to file the return. Effective for estates of decedents dying after July 18, 1984, the election may be made on the first return filed for the estate, regardless of whether the return is delinquent, providing the return is filed no more than one year after the due date, taking into consideration any extensions of time granted to file the return and pay the tax due. See 26 U.S.C. 2032(d) as amended by Public Law 98-369 Section 1024(a). Failure to indicate on the inheritance tax return whether the alternate valuation date is elected shall be construed as a decision not to elect the alternate valuation date.

86.10(2) *When not available.*

a. The alternate valuation date provided for in 26 U.S.C. Section 2032 cannot be elected by the estate if the tax on a future property interest has been deferred under Iowa Code sections 450.44 to 450.49. The tax on a future property interest must be computed on the fair market value of the future property interest at the time the tax is paid. *In re Estate of Wickham,* 241 Iowa 198, 40 N.W. 2d 469 (1950).

b. Real estate which is subject to an additional inheritance tax imposed by Iowa Code section 450B.3 due to the early disposition or cessation of the qualified use cannot be valued at the alternate valuation date for purposes of the recapture tax, unless the alternate valuation date was originally elected on the return for the decedent's estate.

c. The alternate valuation date cannot be elected if the size of the gross estate for federal estate tax purposes, based on the fair market value of the assets at the time of death, is less than the minimum filing requirements ($275,000 for 1983) specified in 26 U.S.C. Section 6018(a). The fact the gross estate for inheritance tax purposes is less than the minimum federal estate tax filing requirement is not relevant.

This rule is intended to implement Iowa Code sections 422.3 and 450.37.

701—86.11(450) Valuation—special problem areas.

86.11(1) *Valuation of life estate and remainder interests.* In general. Life or term estates and remainders in property cannot be valued separately for inheritance tax purposes without reference to the value of the property in which the life or term estate and remainder exists. The first valuation step is to determine the value of the property as a whole. This rule applies equally to fair market value in the ordinary course of trade, whether it be valued at death or on the alternate valuation date six months after death, or at its special use value under Iowa Code chapter 450B. The second step is to apply the life estate-remainder or term tables in rule 701—86.7(450) to the whole value of the property in which the life estate-remainder or term exists. Iowa Code section 450.51 requires that value of annuities, life or term, deferred or future estates in property be computed on the basis that the use of the property is worth a return of 4 percent per year. The life estate-remainder tables in rule 701—86.7(450) make no distinction between the life expectancy of males and females. See *City of Los Angeles v. Manhart,* 435 U.S. 702, 98 S.Ct. 1370, 55 L.Ed. 657 (1978) and *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris,* 51 U.S. Law Week 5243, 77 L.Ed.2d 1238 (1983) for the requirement that retirement annuities must not discriminate on the basis of sex. However, the actual life expectancy of the particular person receiving the life estate is not relevant in determining the value of the life estate for inheritance tax purposes. *In re Estate of Evans,* 255 N.W.2d 99 (Iowa 1977), appeal dismissed, 434 U.S. 805, 98 S.Ct. 34, 54 L.Ed.2d 62.

86.11(2) *Single life estate and remainder.* The value of a single life estate and remainder in property is computed by first determining the value of the property as a whole. The life estate is then computed by multiplying the value of the property as a whole by the life estate factor in rule 86.7(450) for the age of the life tenant. The value of property remaining after the value of the life estate is subtracted is the value of the remainder interest in the property.

The computation of the value of a single life estate and remainder in property is illustrated by the following:

EXAMPLE: Decedent A, by will, devised to surviving spouse B, age 68, a life estate in a 160-acre farm, with the remainder at B's death to daughter C. Special use value and the alternate value were not elected. The 160-acre farm at the time of the decedent's death had a fair market value of $2,000 per acre, or $320,000.

COMPUTATION OF B's LIFE ESTATE: The life estate factor for a life tenant aged 68 under 86.7(450) is .31829; that is, the use of the $320,000 for life at the statutory rate of return of 4 percent is worth 31.829 percent of the value of the farm. Daughter C's remainder factor is .68171. The life estate-remainder factors when combined equal 100 percent of the value of the property. It is the age of the life tenant which governs the value of the remainder. The age of the person receiving the remainder is not relevant.

Value of B's Life Estate	$320,000 × .31829 = $101,852.80
Value of C's Remainder	$320,000 × .68171 = $218,147.20
Total Value	$320,000.00

86.11(3) *Joint and succeeding life estates.* If property includable in the gross estate is subject to succeeding or joint life estates, the following general rules shall govern their valuation:

a. There can be no greater value assigned to all of the life estate interests than the value of the life estate of the youngest life tenant. The value of the life estate of the youngest life tenant fixes the value of the remainder interest in the property.

b. If two or more persons share in a life estate, the life tenants are presumed to share equally in the life estate during the life of the older life tenant, unless the will or trust instrument specifically directs that the income or use may be allocated otherwise.

c. The age of a life tenant alone determines the value of that life tenant's interest in the property. The life tenant's state of health is not relevant to valuation. *In re Estate of Evans*, 225 N.W.2d 99 (Iowa 1977), appeal dismissed, 434 U.S. 805, 98 S.Ct. 34, 54 L.Ed.62. As a result, if a succeeding life tenant is older than the preceding life tenant, the value of the succeeding life estate is zero. These general rules can be illustrated by the following examples:

EXAMPLE 1. Decedent A, by will, devised a 160-acre farm to surviving spouse B, aged 68, for life, and upon B's death, to daughter C, aged 45, for life, and the remainder upon C's death to C's daughters, D and E, in equal shares. The 160-acre farm had a fair market value at A's death of $320,000. Neither the alternate valuation date nor special use value was elected.

COMPUTATION OF THE SUCCEEDING LIFE ESTATES AND REMAINDER

1. Value of B's Life Estate:		
Life estate factor for age 68 is .31829		
$320,000 × .31829 =		$101,852.80
2. Value of C's Succeeding Life Estate		
Life estate factor for age 45 is .62044		
Remainder factor for a life tenant aged 45 is .37956		
$320,000 × .62044 =	$198,540.80	
Less: B's life estate	101,852.80	
Value of C's life estate		$ 96,688.00
3. Value of D's ½ remainder		
½ of $320,000 × .37956 =		$ 60,729.60
4. Value of E's ½ remainder (same as D's)		$ 60,729.60
Total Value — life estates and remainders		$320,000.00

NOTE: In this example the value of C's succeeding life estate is reduced by the value of B's preceding life estate because C does not have the use of the farm during B's lifetime. The value of the remainder to D and E is fixed by the age of their mother, C, the succeeding life tenant.

EXAMPLE 2: Joint and survivorship life estates and remainder. In this example, the estate elected both the alternate valuation date and special use value. This is permitted by Federal Revenue Ruling 83-31 (1983) if the gross estate and the real estate are otherwise qualified.

Decedent A, a widow, by will devised her 240-acre Iowa farm to her son, B, aged 52, and her daughter-in-law, C, aged 48, for their joint lives and for the life of the survivor, with the remainder to D and E in equal shares. The farm had a fair market value at death of $2,200 per acre, or $528,000; the alternate value of the farm six months after death was $2,100 per acre or $504,000. Its special use value is $1,000 per acre or $240,000. The life estates and the remainder are computed on the basis of the special use value of $240,000.

COMPUTATION OF JOINT LIFE ESTATE — REMAINDER VALUES

1. B's share of joint life estate.		
$240,000 × .53412 (life estate factor, age 52) =	$128,188.80	
½ as B's share =		$ 64,094.40
2. C's share of joint life estate.		
$240,000 × .58464 (life estate factor, age 48) =	$140,313.60	
Less: value of life estate for B's life	$128,188.80	
	$ 12,124.80	
Plus: ½ value of life estate for B's life	$ 64,094.40	$ 76,219.20
3. Value of the remainder.		
The value of the remainder is computed by using the remainder factor at the age of the youngest life tenant. In this example, it is .41536, based on C's age of 48.		
D's share of the remainder.		
½ $240,000 × .41536 =		$ 49,843.20
E's share of the remainder.		
Same as D's		$ 49,843.20
Total value of joint life estates and the remainder		$240,000.00

NOTE: In this example B and C share equally in the life use of the farm during the life of B, who is the eldest. As a result, each life tenant's share during B's life is worth $64,094.40. Since C is younger than B, the difference between the value of the life estates for B and C is set off to C alone. The age of the youngest life tenant (C in this example) fixes the value of the remainder interest in the farm.

86.11(4) *Fixed sum annuity for life or for a term of years.* The value of an annuity for a fixed sum of money, either for the life of the annuitant or for a specific period of time, shall be computed by determining the present value of the future annuity payments using the 4 percent annuity tables in rule 86.7(450). A fixed sum annuity, either for life or for a term of years, is to be distinguished from a life estate and remainder in property. A life estate in property is the use of property and the present value of the life use cannot exceed the value of the property in which the life estate-remainder exists, regardless of the rate of return used to determine the life estate factor. A fixed sum annuity on the other hand is different. The amount of annuity does not necessarily bear any relationship to the earning capacity or value of the property which funds the annuity. The fixed sum annuity may be for an amount larger than the 4 percent used to compute a life estate. As a result, the present value of the fixed sum annuity computed at the statutory rate of 4 percent per year, may exceed the value of the property which funds the fixed annuity. In this case the present value of the future annuity payments cannot exceed the value of the property which funds the annuity. The remainder in this situation has no value for inheritance tax purposes.

This subrule is illustrated by the following examples:

EXAMPLE 1. Decedent A devises a 240-acre farm to daughter B, with the provision that B pay the sum $5,000 per year to C for life. The farm is subject to a lien as security for the payment of the annuity. C, the annuitant, is 54 years old. The fair market value of the farm at A's death is $2,000 per acre, or $480,000. Neither special use value nor the alternate valuation date was elected.

COMPUTATION OF THE VALUE OF THE $5,000 ANNUITY AND THE REMAINDER REVERSION TO B. Under rule 86.7(450) the 4 percent annuity factor for life at age 54 is 12.697 for each dollar of the annuity received. Therefore, C's life annuity is computed as follows:

C's Annuity		
$5,000 × 12.697 =		$ 63,485
B's Reversionary — Remainder Interest		
Value of farm	$480,000	
Less: C's annuity	$ 63,485	$416,515
Total annuity and reversion — remainder		$480,000

NOTE: In this example the $5,000 annuity is worth less than a life estate in the farm. A life estate would be worth $243,782.40 because the use of $480,000 at 4 percent per year would return $19,200 per year, which is much greater than the $5,000 annuity.

EXAMPLE 2: Decedent A, by will, directed that the sum of $100,000 be set aside from the residuary estate to be held in trust to pay $500 per month to B for life and upon B's death the remaining principal and income, if any, is to be paid to C and D in equal shares. B, the annuitant, was 35 years old at the time of A's death.

Under rule 86.7(450) the annuity factor for a person 35 years of age is 18.098 for each dollar of the annuity. The annuity factor is based on the annual amount of the annuity, which in this case is $6,000 per year.

COMPUTATION OF THE PRESENT VALUE OF B'S $6,000 ANNUITY

$500.00 × 12 = $6,000 × 18.098 = $108,588, which exceeds the value of the property funding the annuity. As a result, the value for inheritance tax purposes is $100,000, the maximum amount allowed by subrule 86.11(4). The remainder to C and D has no value for inheritance tax purposes.

86.11(5) *Valuation of remainder interests.* Iowa Code section 450.51 and rule 86.7(450) require the value of a remainder interest in property to be computed by subtracting the present value of the preceding life or term estate from the total value of the property in which the remainder exists. Since age or time is the controlling factor in valuing life or term estates in property, the time when the preceding life or term estate is valued is crucial for determining the value of the remainder interests in the property. Iowa Code sections 450.6, 450.44 and 450.52 provide three alternative dates for valuing a remainder, or other property interest in future possession or enjoyment, for inheritance tax purposes. Each of the three dates requires valuing the preceding life or term estate on the date selected, thus in effect, valuing the remainder interest at the same time. The value of the remainder interest is based on the value of the property on the date elected for payment. *In re Estate of Wickham*, 241 Iowa 198, 40 N.W.2d 469 (1950). The remainder or term factor in rule 86.7(450) which is based on the age of the life tenant, or the number of years remaining in the term on the date of payment, is then applied to the value of the property to determine the value of the remainder interest. *In re Estate of Millard*, 251 Iowa 1282, 105 N.W. 2d 95 (1960). Therefore, the remainder, or other future property interest, shall be valued by the following general rules.

a. If the tax on a remainder or other future property interest is paid within 9 months after the decedent's death (12 months for estates of decedents dying prior to July 1, 1981), the tax is to be based on the value of the property at the time of the decedent's death (whether it is fair market value or special use value) or the alternate value, 6 months after death, if elected. The age of the life tenant at the time of the decedent's death (the youngest life tenant in case of succeeding or joint life estates), or the term of years specified in the will or trust instrument, must be used to determine the value of the life estate or term estate in computing the tax on the remainder or other future property interests.

b. If the tax is paid after nine months from the date of the decedent's death (one year for estates of decedents dying prior to July 1, 1981), but before the termination of the previous life or term estate, the tax on the remainder or other future property interest shall be computed on the fair market value of the property at the time of payment using the life estate or term factor based on the life tenant's age or term of years remaining at the time the tax is paid. Neither the alternate value nor special use value can be used to value the property after nine months from the date of the decedent's death.

c. If the tax on the remainder or other future property interest is not paid under paragraphs *"a"* and *"b,"* the tax must be paid within nine months (one year for future property interests created prior to July 1, 1981) after the termination of the prior estate. In this case the tax is based on the fair market value of the property and the life estate remainder or term factor corresponding with the time the prior estate is terminated. If the prior estate is terminated due to the death of the life tenant, or due to the expiration of the term of years, the remainder factor is 100 percent of the value of the property. If the prior estate terminates during the life of the life tenant or during the term of years, the tax is computed in the same manner as provided in paragraph *"b."* If the tax is not paid within nine months (one year for future property interests created prior to July 1, 1981) after the termination of the prior estate, the tax owing is delinquent and is subject to penalty and interest as provided by law. However, in this case the value of the remainder interest is not modified to reflect any change in the fair market value of the property or the life or term estate factor that may occur, due to the lapse of time between the due date of the tax and the date the tax is paid.

d. Iowa Code section 450.52 provides that the tax may be paid at any time on the present worth of the future property interest. The term "present worth" means the value of the future property interest at the time the tax is paid. Therefore, if the tax on the remainder or other future property interest is not paid within nine months after the decedent's death (one year for future property interests created prior to July 1, 1981), the estate or the beneficiary receiving the future interest cannot pay the tax on a delinquent basis using a value and a life estate or term factor which does not reflect the present worth of the future interest at the time of payment. In this situation the tax must be computed under paragraph *"b"* or *"c"* of this subrule, whichever applies. In this respect failure to pay the tax within nine months after the decedent's death (one year for future property interests created prior to July 1, 1981) operates as a deferral of the tax on the future property interest. *In re Estate of Dwight E. Clapp,* Probate No. 7251, Clay County Iowa District Court, July 2, 1980.

These rules can be illustrated by the following examples:

EXAMPLE 1: Decedent A died July 1, 1983, and, by will, devised all of her personal property to her surviving spouse, B, and her 240-acre Iowa farm to B for his life with the remainder at B's death to C and D in equal shares. The surviving spouse, B, was 74 years of age when A died. The fair market value of the 240-acre farm was $2,000 per acre, or $480,000 on the date of A's death. Neither the alternate valuation date nor special use value was elected by the estate. On March 15, 1984, the inheritance tax return was filed and the tax paid.

COMPUTATION OF THE REMAINDER INTEREST OF C AND D

Since the return was filed and the tax paid within nine months after the decedent's death, the age of B, the life tenant, and the fair market value of the farm on July 1, 1983, control the value of the remainder. The remainder factor in rule 86.7 (450) for a life tenant 74 years old is .75519.

C's ½ remainder interest	½ $480,000 × .75519 =	$181,245.60
D's ½ remainder interest	same as C's	181,245.60
Total value of remainder		$362,491.20

The difference between the value of the remainder and the total value of the farm is the value of B's life estate.

EXAMPLE 2: Same facts as in Example 1, with the exception that only the tax on B's life estate was paid on March 15, 1984. The tax on the remainder to C and D was therefore deferred, to be paid no later than nine months after the death of B, the life tenant. However, on October 15, 1985, due to adverse economic circumstances, B, C, and D voluntarily sell the 240-acre farm at public auction to an unrelated person for $2,100 per acre, or $504,000. B's life estate was not preserved in the sale proceeds. The tax on the remainder in this fact situation must be computed under subrule 86.11(5), paragraph *"b,"* when the life estate is terminated before the life tenant's death. The sale price of the farm and the life estate remainder factor reflecting B's age on October 15, 1985 (B's age is now 76) control the value of the remainder.

COMPUTATION OF THE REMAINDER INTEREST OF C AND D

The remainder factor in rule 86.7(450) for a life tenant aged 76 is .77825.

C's ½ remainder interest	½ $504,000 × .77825 =	$196,119.00
D's ½ remainder interest	same as C's	196,119.00
Total value of remainder		$392,238.00

NOTE: In this example, the value of C and D's remainder interest in the sale proceeds is greater than the value of the remainder at the time of A's death due to the increase in the remainder factor because of B's increased age and the increase in the fair market value of the farm. However, if B's life estate had been preserved in the sale proceeds, the tax could continue to be deferred on C and D's remainder interest. C and D cannot be required to pay the tax on their remainder until they come into possession or enjoyment of the property.

EXAMPLE 3: Decedent A at the time of her death on July 1, 1983, owned a vested remainder in a 240-acre Iowa farm, which was subject to the life use of her mother, B, who was 87 years old when A died. A's ownership of the remainder interest was not discovered until after life tenant B's death on October 15, 1985. The fair market value of the farm was $2,000 per acre or $480,000 on July 1, 1983, and $2,200 per acre or $528,000 on October 15, 1985. Neither the alternate valuation date nor special use valuation can be used in this fact situation. See rule 86.10(450) and subrule 86.8(4), paragraph *"c."* A's estate was reopened to include the omitted remainder in the 240-acre farm. An amended inheritance tax return was filed December 10, 1985, basing the tax on the fair market value and the remainder factor corresponding with the life tenant's age (87) on July 1, 1983. In this fact situation the tax on A's remainder is not computed correctly, even if A's estate has offered to pay a penalty and interest on the tax due. The tax must be computed on the basis of a fair market value of $2,200 per acre and a remainder factor of 100 percent of the value of the farm. No penalty or interest would be assessed if the correct tax is paid prior to July 15, 1986, which is nine months after the life tenant's death. The life tenant's age at death is not relevant.

86.11(6) *Valuation of contingent property interests.* Contingent remainders, succeeding life estates and other contingent property interests must be valued as if no contingency exists. As a result, subrule 86.11(5) applies equally to the valuation of vested and contingent property interests. The tax on a contingent property interest may be deferred until such time as it can be determined who will come into possession or enjoyment of the property. By deferring the tax under Iowa Code sections 450.44 to 450.49, a person does not have to speculate as to who will be the probable owner of the contingent interest. As a result, no one is required to pay tax on a property interest to which a vested right has not been received. Therefore, if a person exercises the right to pay the tax during the period of the contingency, that person cannot obtain a tax advantage by asserting that the value should be reduced due to a contingency, when the person would not be entitled to a reduction in value if the tax had been deferred until the ownership is determined.

This rule is illustrated by the following example.

COMPREHENSIVE EXAMPLE: Decedent A, by will, devised a 240-acre Iowa farm to B for life and upon B's death, then to C for life and the remainder after C's death to D and E in equal shares. In this example C's succeeding life estate is contingent upon surviving B, the first life tenant. If C elects to pay the tax on the succeeding life estate within nine months after A's death, the tax is computed according to Example 1 in subrule 86.11(3) with no discount for the contingency that C may not survive B. However, C may defer the tax to be paid no later than nine months after B's death. In this case, if C does not survive B, the succeeding life estate lapses, and D and E who own the remainder will come into possession or enjoyment of the 240-acre farm. No tax will be owing on the succeeding life estate because C receives nothing. D and E will owe tax on the remainder within nine months after the death of B, if the tax was not previously paid.

This rule is intended to implement Iowa Code sections 450.44 to 450.49, 450.51 and 450.52.

701—86.12(450) The inheritance tax clearance.

86.12(1) *In general.* The inheritance tax clearance is a written certificate of the department documenting the satisfaction of the inheritance tax obligation of the persons succeeding to the property included in the gross estate and the personal representative of the estate, and also the obligation of the qualified heir, in case special use valuation is elected under Iowa Code chapter 450B. The clearance is either in the form of a full payment tax receipt or a statement that no tax is due on the shares of the estate. Even though the department of revenue and finance has issued an inheritance tax clearance, the tax may be subject to change as a result of any federal estate tax changes affecting the Iowa inheritance tax. Absent an agreement to the contrary, the six-month extension of the statute of limitations for assessing Iowa inheritance tax based on federal audit adjustments is limited to federal audit adjustments that directly affect Iowa inheritance tax and involve Iowa inheritance tax law that incorporates Internal Revenue Code provisions—see Iowa Code section 450.94(5) and *Kelly-Springfield Tire Co. v. Iowa State Board of Tax Review*, 414 N.W.2d 113 (Iowa 1987).

86.12(2) *Limitations on the clearance.* Limitations on the inheritance clearance include, but are not limited to:

a. If special use valuation has been elected under Iowa Code chapter 450B, a clearance certifying all inheritance tax has been paid in full, or that no inheritance tax is due, does not extend to any additional inheritance tax that may be imposed under Iowa Code section 450B.3 by reason of the early disposition or early cessation of the qualified use of the real estate specially valued. Provided, this limitation shall be null and void if:

(1) The real estate specially valued remains in qualified use for the ten-year period after the decedent's death, or

(2) There is an early disposition or early cessation of the qualified use and any additional inheritance tax imposed by Iowa Code section 450B.3 is paid in full.

b. The clearance does not extend to property that is not reported on the return.

c. The clearance does not extend to a fraudulently filed return or a return which misrepresents a material fact.

d. The clearance does not release an underlying tax obligation that remains unpaid, even though a clearance may release the liens imposed by Iowa Code sections 450.7 and 450B.6.

86.12(3) *The tax paid in full clearance.* Effective for estates of decedents dying on or after July 1, 1983, the distinction between full payment and partial payment clearances is abolished. For estates of decedents dying on or after July 1, 1983, in which a tax is due, only full payment clearances will be issued. The full payment clearance will be issued only after all the tax, penalty and interest have been paid in full. Provided, if the tax has been paid in full on some, but not all of the shares in the estate, the department will, upon request, issue a full payment clearance limited to those shares on which the tax has been paid in full. The inheritance tax is a separate tax on each share of the estate and not one tax on the estate itself. *In re Estate of Stone,* 132 Iowa 136, 109 N.W. 455 (1906). However, see subrule 86.12(2), paragraph *"a,"* for the limitation on clearances if the estate elected the special use valuation under Iowa Code chapter 450B.

86.12(4) *The no tax due clearance.* If no tax is found to be due on any of the shares of the estate, the department will issue a clearance certifying that no tax is due, subject to the limitations in subrule 86.12(2).

86.12(5) *Clearance releases the lien.*

a. In general. Two inheritance tax liens have been created by statute to secure the payment of an inheritance tax. The lien created by Iowa Code section 450.7 secures the payment of the tax imposed by Iowa Code section 450.3, regardless of whether the tax is based on market value in the ordinary course of trade, the alternate value or special use value. Iowa Code section 450B.6 creates a second lien to secure the additional inheritance tax that may be due by reason of the early disposition or early cessation of the qualified use of special use valuation property.

b. The section 450.7 lien. A tax clearance which is not specifically limited to certain property or shares of the estate releases the lien imposed by Iowa Code section 450.7 on all of the property in the gross estate that is reported on the return. If a payment clearance is limited to some of the shares of the estate, but not all of the shares, the lien is only released on the reported property in those shares where the tax has been paid in full.

Effective for estates of decedents dying on or after July 1, 1984, if a tax, or additional tax, is found to be due after the issuance of an inheritance tax clearance, which is not limited as to specific shares or property, the lien under Iowa Code section 450.7 does not have priority against subsequent mortgages, purchases or judgment creditors, unless the department gives notice of the lien by recording the notice in the office of the recorder of the county where the estate is probated, or in the county where the property is located, if the estate has not been administered. As a result, if the department has issued an inheritance tax clearance, which is not limited as to specific beneficiaries or property, an examiner of real estate or personal property titles can rely on this clearance as a release of the inheritance tax lien even though additional tax may be due, if the department has not filed, after issuing its clearance, a notice of its lien for tax or additional tax due. This subrule only pertains to the security for the tax under the lien provisions of Iowa Code section 450.7. Other provisions for security for payment of the tax such as: judgment liens, mortgages, bonds, distress warrants, etc., are not affected by this subrule. See Iowa Code section 450B.6 and subrule 86.8(15) for the lien for additional tax on property which has been valued at its special use value.

This subrule can be illustrated by the following example:

EXAMPLE: Decedent A died August 15, 1984, a resident of Iowa. By will A devised a 160-acre farm to son B and all personal property to daughter C. The net estate consisted of the farm with a fair market value of $2,000 per acre, or $320,000 and personal property worth $320,000. On May 24, 1985, the inheritance tax return was filed and tax of $34,850.00 ($17,425 for each child) was paid. The department issued its unqualified inheritance tax clearance on June 13, 1985. On July 5, 1985, C pledges some corporate stock inherited from A as security for a bank loan. On August 1, 1985, additional personal property was discovered worth $10,000 and an amended inheritance tax return was filed without remittance. On August 15, 1985, the department filed an inheritance tax lien for the $800 additional tax plus interest (no penalty was imposed because 90 percent of the tax was timely paid).

In this example the bank's lien on the pledged corporate stock is superior to the inheritance tax lien under Iowa Code section 450.7 because at the time the stock was pledged (July 5, 1985) the department had not filed its lien for the additional tax owing. Since only C owed additional tax, B's share of the estate was not subject to the lien filed August 15, 1985.

c. The section 450B.6 lien. This lien has no application to estates of decedents dying prior to July 1, 1982. In estates of decedents dying on or after July 1, 1982, the lien only applies to the property which has been specially valued under Iowa Code chapter 450B. A clearance certifying full payment of the additional inheritance tax imposed by Iowa Code section 450B.3 releases the lien on the property which was subject to the additional tax. Since the lien imposed by Iowa Code section 450B.6 expires automatically ten years after the decedent's death on property remaining in qualified use during the ten-year period, a tax clearance is not required.

86.12(6) *Distribution of the clearance.* Effective for estates of decedents dying on or after July 1, 1983, only an original inheritance tax clearance will be issued by the department. The personal representative is required to designate on the return who is to receive the clearance. If the return fails to designate a recipient, the clearance will be sent to the clerk of the district court.

Rules 86.9(450) to 86.12(450) are intended to implement Iowa Code chapter 17A and sections 450.5, 450.7, 450.58, 450.64, 450B.2, 450B.3, 450B.6, 633.477, and 633.479.

701—86.13(450) No lien on the surviving spouse's share of the estate. Effective for estates of decedents dying on or after January 1, 1988, no inheritance tax lien is imposed on the share of the decedent's estate passing to the surviving spouse. In addition, effective for estates of decedents dying on or after July 1, 1997, no inheritance tax lien is imposed on the share of the decedent's estate passing to the decedent's parents, grandparents, great-grandparents, and other lineal ascendants, children (including legally adopted children and biological children entitled to inherit under the laws of this state), grandchildren, great-grandchildren, and other lineal descendants and stepchildren.

This rule is intended to implement Iowa Code sections 450.7(1) and 450.12 as amended by 1997 Iowa Acts, Senate File 35.

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